

THE BALANCING OF CREDITOR INTERESTS IN BUSINESS RESCUE PROVISIONS
OF THE COMPANIES ACT 2008

BY

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SUPERVISOR: The Hon. Judge Dennis Davis

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DECLARATION

I declare that this dissertation is my own work and has not been submitted in any form for another degree or diploma at any University or other institution of tertiary education. Information derived from the published or unpublished work of others has been acknowledged in the text and in a list of references given.

All legal references are detailed as at January 2017.

Signed by candidate

.....
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The Assistance of the NRF in relation to this work is acknowledged

ABSTRACT:

The integrated global economy has presented challenges as well as opportunities for companies and their surrounding communities. This has resulted in many jurisdictions having to re-evaluate the question of company failure and how best to deal with it.

The South African context has seen the enactment of a new Companies Act, ushering in a rescue regime which evidences a significant departure from its predecessor; judicial management. Contained within Chapter 6 of the Companies Act of 2008, business rescue adopts a fresh approach to company resuscitation. With relatively easy access to the procedure, business rescue caters for the restructure of the business, debt or its equity to ensure either a return to solvency or a better return to creditors than in liquidation.

The new regime is further underpinned by the 2008 Act purpose provision, which envisages an efficient business rescue procedure and further mandates that the resolution of financial distress be conducted in a manner that balances the rights and interests of all relevant stakeholders. It is in this light, that this study explores the interplay between section 7(k) and Chapter 6 of the new Act. Specifically, the work sets out to critique the manner in which our new business rescue regime balances competing stakeholder interests in its provisions and investigates whether current provisions provide an adequate framework for this to be done in a manner that enhances the regime's ability to return a financially distressed company to a position of solvency, as a primary objective.

After discussing the previous judicial management regime and exploring the mechanics of Chapter 6, a comparative study of similar procedures in the United Kingdom and the United States is undertaken. The study further identifies a number of weaknesses and makes recommendation for improvement.

STATEMENT OF SOURCES

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- 'Can a man change his stars?'

- 'Yes William. If he believes enough, a man can do anything...'

--- Extract from the movie *A Knights Tale*

And with that exchange between William and his father, I am taken back to home: Langa Township, not too distant from the prestigious University of Cape Town and clearly visible from Jameson Hall steps. The absence of its 'twin towers' now strikingly unfamiliar. I am taken back to early school morning where my paternal grandmother would make my siblings and I share our bath water from those old enamel washing tubs, the infamous waskom. I, the boy, having to wash last in now lukewarm water littered with soap scum. While I was unconvinced and sceptical regarding the water's cleansing efficacy, here I now stand: To my paternal grandmother, a domestic unwittingly charged with the responsibility of raising her son's (my father) many children, I express my undying gratitude: Thobeka Jane Maqhubela (nee Buba), thank you.

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If not anything else this work, to me, is an affirmation of the strength of human will.

Zolani Mphankomo Qengeba Buba

South Africa

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CHAPTER 1: INTRODUCTION

1.1 BUSINESS RESCUE, AN INTRODUCTORY ANALYSIS

The company law reform process began in 2004, culminating in the enactment of the Companies Act of 2008. It had as its objective the overhauling of South Africa's company law regime. The vision and objective of the new company law dispensation was contained in the Department of Trade and Industry Paper dated May 2004 entitled 'South Africa for the 21st Century: Guidelines for Corporate law Reform'.¹

There was a clear desire on the part of government to align company law with prevailing international trends. Changes to the company law regime in England (from which a large volume of our company law originates) were cited as a factor which prompted the need for company law reform. A further motivation was to ensure that our company law regime be aligned with the enactment of the Constitution of South Africa.²

The socio-political framework within which the new company regime was to be developed is important for two reasons. It provides context for the paradigmatic shift regarding the purpose of company law within the South African context, evidencing a clear shift from its historical roots where law's purpose was simply to create a framework regulating commercial transactions between two or more parties. It is this aspect that enables a theoretical platform for an analysis into the nature of the corporation, and an appropriate framework within which the new company law regime is to develop.

The second reason is that this provides a basis for understanding the 'rights and duty language' permeating through the Companies Act of 2008, what this means within the context of the new company law framework as well as how it impacts on the analysis to be engaged in later chapters. Prior to putting forward the hypothesis that the thesis advances, a brief reference to contemporary history is necessary. This reference allows for an understanding of what the legislature sought to achieve in its overhaul of South Africa's company law. It is important to understand the context in which this change came about to

¹ It is to be noted that prior to this at least two other law reform initiatives had been engaged in for the overhaul of both rescue as well as insolvency law. Around 2000 Cabinet approved a draft Insolvency and Business Recovery Bill, which was drafted by the Centre for Advanced Corporate Insolvency Law at the University of Pretoria resulting in the document titled *Final Report Containing Proposals on a Unified Insolvency Act* published in August 2000. This was combined with the Law Reform Commission's draft Insolvency Bill. The second initiative consisted of a plan communicated by the Chief State Law Adviser, of government's intention to make available R 2 billion a year to assist in the rescuing of companies, which was succeeded by rumours of a new Business Recovery Bill. Even though both efforts seemed to fizzle out without formal explanation, the Department of Trade and Industry's *Guidelines on Corporate Law Reform* emerged thereafter. For further reading on this aspect see Anneli Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD Thesis University of Pretoria 2010).

² Constitution of the Republic of South Africa Act 108 of 1996.

assess the consequences that have arisen as a result, in the form of the current legislative provisions.

In 1992 the King Committee³ was formed. Its purpose was to consider corporate governance in South Africa and promote standards consistent with international best practices.⁴ In its consideration of South Africa's corporate governance framework, the committee advocated an integrated approach which emphasised good governance in the interests of a wide range of stakeholders.⁵ It incorporated principles of good financial, social, environmental and ethical practices.⁶ In this way the King Committee formalised the expression that companies could no longer ignore the society and environment in which their operations were situated.⁷

Articulating its recommendations in relation to the responsibility of the corporation towards its stakeholders, the committee stated:

...The modern approach is for a board to identify the company's stakeholders, including its shareowners, and to agree policies as to how the relationship with those stakeholders should be advanced and managed in the interests of the company. Wherever the term "stakeholder" is applied in this Report, it is used in the sense enunciated in this paragraph...Boards have to consider not only the regulatory aspect, but also industry and market standards, industry reputation, the investigative media, and the attitudes of customers, suppliers, consumers, employees, investors and the communities (local, national and international), ethical pressure groups, public opinion, public confidence, political opinion etc...The inclusive approach recognizes that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers need to be considered when developing the strategy of a company. The relationship between the company and these stakeholders is either contractual or non-contractual.⁸

As may be observed, the definition of stakeholder is expansive.⁹ Due to its broad nature, it encompasses a number of parties who may hold interchangeable positions in relation to the debtor company, and provides a framework for the thesis' emphasis on the treatment of creditor interests specifically as well as how this potentially influences the efficacy of our regime.¹⁰ The King Committee's recommendations were echoed in the King

³ Institute of Directors 'King Report on Corporate Governance for South Africa 2002: King Committee on Corporate Governance' (Published March 2002). It is to be noted that the history of South African company law extends back much further than this period. The historical aspect is canvassed in greater detail in chapter 2.

⁴ Institute of Directors (2002) at 7.

⁵ Institute of Directors (2002) at 7.

⁶ Ibid.

⁷ Ibid.

⁸ Institute of Directors at 7-8.

⁹ The Oxford online dictionary defines the term as '...2. A person with an interest or concern in something, especially a business 3. Denoting a type of organization or system in which all the members or participants are seen as having an interest in its success: *'a stakeholder economy'*. Available online at <http://www.oxforddictionaries.com/definition/english/stakeholder> accessed on 19 August 2016.

¹⁰ Three examples which come to mind are that of a tax authority, an employee and a supplier or financier. While the word creditor is often applied to denote the supplier/financier, in relation to outstanding payments due by the debtor company, it may very well encompass the two former categories of stakeholder in respect of tax due as well as outstanding wage/ salary payments respectively.

III Report on Corporate Governance:

Although the board is accountable to the company itself, the board should not ignore the legitimate interests and expectations of its stakeholders. In the board's decision-making process, the inclusive approach to corporate governance adopted in King II dictates that the board should take account of the legitimate interests and expectations of the company's stakeholders in making decisions in the best interests of the company... It is recognized that in what is referred to as the 'enlightened shareholder' model as well as the 'stakeholder inclusive' model of corporate governance, the board of directors should also consider the legitimate interests and expectations of stakeholders other than shareholders.¹¹

The approach in King II and III framed the theoretical approach that South African company law would follow. This approach has been transplanted into the provisions of the Companies Act of 2008 which stand in stark contrast to the 1973 Act, which paid fairly negligible concern in its consideration of broader stakeholder constituency interests.¹² The latter's preamble simply stated the purpose of the Act as 'To consolidate and amend the law relating to companies; and to provide for matters incidental thereto'.¹³ This may be contrasted with the 2008 Act's emphasis on a broad stakeholder model, which is seen in its purpose clause and reads as follows:¹⁴

7. The purposes of this Act are to—

- (a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;
- (b) promote the development of the South African economy by—
 - (i) encouraging entrepreneurship and enterprise efficiency;
 - (ii) creating flexibility and simplicity in the formation and maintenance of companies; and
 - (iii) encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation;
- (c) promote innovation and investment in the South African markets;
- (d) reaffirm the concept of the company as a means of achieving economic and social benefits;
- (e) continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy;
- (f) promote the development of companies within all sectors of the economy, and encourage active participation in economic organisation, management and productivity;
- (g) create optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in enterprises and the spreading of economic risk;
- (h) provide for the formation, operation and accountability of non-profit companies in a manner designed to promote, support and enhance the capacity of such companies to perform their functions;
- (i) balance the rights and obligations of shareholders and directors within companies;
- (j) encourage the efficient and responsible management of companies;
- (k) provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders; and
- (l) provide a predictable and effective environment for the efficient regulation of companies.

Without derogating from the importance of each of the above, it is important to emphasise that paragraph (d) affirms the company as a vehicle for achieving socio-economic benefits. Equally significantly, the rescue and recovery of financially distressed companies is

¹¹ Institute of Directors 'King Report on Governance for South Africa' (Published 1 September 2009) at 9 and 12.

¹² This aspect will be canvassed in subsequent chapters.

¹³ Preamble to Companies Act 61 of 1973.

¹⁴ Companies Act 71 of 2008, section 7. This aspect is discussed in Chapter 3.

specifically mandated. The parameters in which this should be done require that a balance be struck between the rights and interests of all relevant stakeholders.¹⁵

These two aspects are critical. This is because the objective of returning a company to solvency (or financial recovery) provides a basis for testing the concept of ‘efficiency’ in company rescue, thus providing a response to the question: Is a return to solvency the most appropriate measure for evaluating the effectiveness of a rescue regime?¹⁶ The second enhances the depth of the critique, specifically directing it to the South African context by attempting to answer the following question: how are interests of the different stakeholders in a rescue to be balanced in a manner that provides both protection for relevant stakeholders and in an efficiency enhancing manner (i.e. in a manner that ensures that the debtor returns to a position of solvency)? These questions are analysed comprehensively throughout the thesis.¹⁷

I now turn to a brief analysis of the business rescue provisions of the Companies Act and the essential hypothesis to be advanced and tested in this work. Despite business rescue’s laudable underpinnings from both a socio-economic and business perspective, there is often incoherence between the desire to make the company a vehicle for enhancing socio-economic objectives while ensuring a regulatory environment conducive to thriving business. This is due to the costs attendant on welfare obligations imposed on the company. In addition, regulation is complex, often resulting in undesirable consequences (i.e. contrary to the intended objective) which were not previously foreseen.

The influence of the labour movement and its position in relation to the rights of employees provides a possible basis for understanding the strong employee orientation seen

¹⁵ Section 7(k).

¹⁶ When compared to alternative objectives such as a sale of business or a wind down. For the purpose of this thesis, it is assumed that it does. For further reading on this aspect see Rachel Siew Lin Lee *How is ‘efficiency’ determined in the insolvency context? Clarifying the meaning of efficiency with the conjunction of insolvency jurisprudence and economic methodology* (PhD Thesis, University of Queensland, 2015). The commentator in her abstract observes how the definition is often contingent on the attributes vested upon a particular insolvency system:

‘Just as the meaning of efficiency varies with jurisprudential context, its properties vary according to the economic methodology it is associated with. Schools of economic thought, like insolvency jurisprudence, are not homogenous, raising the possibility that one may hold to a methodological position that can conflict with the methodology underlying an efficiency criterion...’

¹⁷ See Department of Trade and Industry ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ (GG 26493, General Notice 1183 of 23 June 2004) at 10, whose objective included the creation of a regulatory framework which:

‘...should be consistent, effective, predictable, transparent, fair and understandable. It should provide flexibility and promote adaptability to an environment with fast changing technologies, economic opportunities and social circumstances. The regulatory scheme should not create artificial preferences and distortions, where these are unnecessary. And it should attempt, where practically possible, to balance the competing interests of economic actors and society at large.’

in the business rescue provisions of the Companies Act of 2008. Van Eck *et al* comment on the influence of worker unions as a pressure group during the process:

...It is submitted that the momentum behind the initiatives for the urgent introduction of business rescue provisions in South African Insolvency legislation, currently an issue of high priority at government level, has similarly been fuelled by the labour movement. Thus, the foundations for such an intervention have been laid and the labour fraternity eagerly anticipates further developments in this area...¹⁸

In its submission to NEDLAC Labour Market Chamber, COSATU (Congress of South African Trade Unions) took the following stance on the earlier Insolvency and Business Recovery Bill:

There is a need to open a debate for the inclusion of employees as creditors “holding special security”. An employee is paid in arrears, if the company is liquidated or liquidates itself then in effect the employee has “loaned” his/her work to the employer and should be considered to have a special claim for that amount. The same situation pertains to leave pay and bonus pay as well as all deductions from employees’ wages for medical aid, pension/provident fund. Amounts owing in respect of these categories constitute deferred wage but are often fraudulently treated as if it has been “borrowed” by the company.¹⁹

Despite these submissions not having been formally recorded against what was to form the business rescue provisions of the Act, this view is echoed in both the Explanatory Memorandum to the Companies Bill as well as in the Act’s creditor claim ranking provisions.²⁰

Within this context, the argument advanced is that South African business rescue provisions currently balance stakeholder interests in a manner that potentially prejudices the achievement of rescue and is thus contrary to the provisions of both section 7 broadly and section 128 of the Companies Act of 2008 specifically. Thus, the current form of business rescue may hinder the regime’s ability to effect a rescue in the primary sense, which denotes a return to a position of solvency.

The following reasons²¹ are offered for this submission: (i) The definition of business rescue aggregates creditor welfare, assuming homogeneity in relation to the company’s creditors as if creditors fall into the same class or grouping. In this manner a quasi-utilitarian approach seems to find application, without strong protections for pre-business rescue contractual promises. The effect is that insufficient weight is accorded to different sets of rights which existed prior to commencement of Chapter 6 proceedings. (ii) The regime imposes a fiduciary duty on the practitioner towards the company only rather than towards its

¹⁸ Stefan Van Eck, Andre Boraine & Lee Steyn ‘Fair Labour Practices in South African Insolvency Law’ (2004) 121 Issue 4 *SALJ* 902 at 906.

¹⁹ COSATU submission to the NEDLAC Labour Chamber, 11 May 2004 at 4 available at <http://www.cosatu.org.za/docs/subs/2004/busibill.pdf> accessed on 1 November 2016.

²⁰ Discussed later.

²¹ These are by no means the only challenges observed. A comprehensive discussion of the relevant provisions is engaged in at a later stage.

creditors as well. The consequence is that, strictly speaking, the practitioner is not obliged to ensure that stakeholders are treated equitably *inter partes* during the process as his/her primary duty is towards the debtor. (iii) Employees, as a category of stakeholder, are provided with significant protections in comparison to other unsecured creditors and, in certain instances, in preference to secured interests. These protections are provided notwithstanding those that already exist outside of company law (presumably in labour and insolvency law).

In this way the new regime fails to balance between those who should bear the costs of rescue versus those who benefit. For example, a creditor with real security covering the full liability over the debtor (and who has strong, if not full protection for its claim whether the debtor is revived or liquidated) may have its claim rank lower than a post-commencement employee wage claim (even though the employee does not have security and has more to lose should the rescue attempt fail).²²

In the light thereof, a critique of the new regime's perceived short-comings (from a drafting perspective) is provided and Chapter 6 is then evaluated in the light of approaches in comparative jurisdictions. The South African approach is further compared with international best practices in the form of the UNCITRAL Guide on Insolvency Law.

The dominant aim of business rescue ought to be the resuscitation of the failing enterprise (i.e. its return to solvency) while providing greater protection of creditors as a whole. One group of creditors cannot be expected to make concessions which are disproportionate in relation to those expected from another group. It is not suggested that creditors be treated in exactly the same manner and it is recognised that protection should be given to the most vulnerable class. A company under business rescue often operates under tremendous financial constraints.

1.2 PURPOSE OF RESEARCH

The fast changing economic context within which business in South Africa operates has presented challenges as well as opportunities. The consequences of company failure often have a tremendous effect on communities which rely on the affected company for

²² Eric Levenstein *An appraisal of the new South African business rescue procedure* (LLD Thesis, University of Pretoria, 2016) at 116 in this regard makes similar a observation:

‘But if the benefits of a successful reorganisation are shared, the risks of failure are not. Should a company fail for a second time, it is the creditors who will lose additional funding. A corporate reorganisation is like a gamble in which shareholders, creditors, managers, suppliers and employees win with success, but where only creditors bear the costs of failure...’

In the commentator's view, it is this distribution of costs and benefits which ultimately determines how different stakeholders view the choice between liquidation and rescue.

employment, trade income as suppliers or dividend income as shareholders. Where company failure occurs the State loses a tax base necessary for developing or creating new infrastructure to facilitate further economic growth.

A brief analysis of statistical data on company liquidations may explain the impetus behind the need for company law reform in this area. When the process began, compulsory company liquidation figures for July to September 2003 stood at 1211 as compared to a figure of 1050 over July to September 2002.²³ The figures recorded a 38.7% increase in liquidations for September 2003 in comparison to the figure for September the previous year.

The 38.7% increase was due to a 55.7% increase in compulsory liquidations and a 34.2% increase in voluntary liquidations when compared to September 2002 figures. Generally, a 3.1% increase in liquidations overall over the first nine months of 2003 was recorded, when compared to the previous year over the same period. Even during the latter period, the percentage of compulsory liquidations (4.2%) was significantly higher than that seen in voluntary liquidation numbers (2.9%). Positively, these figures showed a slight decrease in the fourth quarter of 2004 with a 6.2% decrease in liquidations in the month of September 2004 when compared to September 2003. The nine month liquidation figure was also said to have decreased by 13.4% in comparison to the previous year.

Compulsory liquidations occur as a result of the debtor company's inability to discharge of debt. It may be concluded that these figures evidenced judicial management's failure to provide a reprieve and an opportunity at a new start for the ailing debtor. A similar observation is made by Mongalo in his summation of the company law reform process:

At the time, there was already widespread acceptance that the existing judicial management process under chapter xv of the Companies Act of 1973 was failing the local economy as few if any, judicial management processes resulted in success. Consequently, predictability, effectiveness and flexibility guided reform.²⁴

Company failure may be understood to impact directly on employment.²⁵ The figures provide a framework for understanding factors which may have contributed to the pendulum

²³ Statistics South Africa *Statistics of Liquidations and Insolvencies (preliminary) September 2003* (Embargoed until October 2003) at 1; Statistics South Africa *Statistics of Liquidations and Insolvencies (preliminary) September 2004* (Embargoed until October 2004) at 1.

²⁴ Tshepo Mongalo 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) *Acta Juridica* xiii-xvi. The weaknesses of the judicial management regime are given comprehensive discussion in Chapter 3.

²⁵ For a broad outline of unemployment statistics during this period, see Statistics South Africa *Labour Force Survey September 2003* (Published 25 March 2004); *South Africa Labour Force Survey September 2004* (Published March 2005).

swinging in favour of employee interests within the context of a regime whose primary focus should be financial resuscitation.²⁶

This study enables the construction of a theory, which attempts to explain the nature, extent and justification for legislative intervention in the form of the business rescue regime within the South African context.²⁷ It also develops an understanding of how different jurisdictions such as the United States and United Kingdom have approached the rescuing of businesses and why they have chosen certain approaches. Because business rescue provisions in the 2008 Act are a multi-jurisdictional hybrid, having largely been influenced by approaches in the United States and United Kingdom, the approaches in these jurisdictions are explored in some detail.²⁸

With this understanding, it then will be possible to critique the *manner* in which comparative jurisdictions have sought to achieve these goals as well as to analyse consequences that flow therefrom. This in turn, enables an assessment of the strengths and potential areas of improvement for business rescue legislation in South Africa. Upon the completion of this exercise, amendments to the current business rescue provisions are advocated.

It is hoped that suggested reforms will strengthen the new regime and create an environment that enables the resuscitation of the company, providing for continuity as well as the reaping of benefits by communities within which the company operates.

1.3 OBJECTIVE OF RESEARCH

The objective of this research is to argue for a particular business rescue regime. The need to accelerate economic development and translate the benefits therefrom to communities in which companies operate provides a justification for the imposition of welfare obligations upon the company through legislative regulation.²⁹ As a corollary, the question whether it is the role of the corporation or of government to fulfil these socio-economic imperatives, is

²⁶ Stefan Van Eck, Andre Boraine and Lee Steyn 'Fair Labour Practices in South African Insolvency Law' (2004) 121 *SALJ* 902 at 906.

²⁷ This is developed in the next chapter

²⁸ It is by no means suggested that these jurisdictions are the only ones which have had an impact on our own. In relation to the shifting international trend towards 'debtor-friendly' rescue regimes, see Richard Bradstreet 'The New Business Rescue: Will Creditors Sink or Swim' (2011) 128 Issue 2 *SALJ* 352 at 354 who observes as follows:

‘...The general idea is that debtor-friendly corporate rescue legislation is more likely to be successful.

Although the forerunner of this bargain-oriented approach was the United States, this prototype legislation has been subject to much criticism and other jurisdictions that later followed suit have proved to be better sources of influence for South Africa's reform.’

²⁹ The different theories of the corporation are explored in the next chapter and a view is put forward as to the theory which best accounts for the nature of the corporation and in whose interests the corporation must be managed.

then explored.

While framing the conceptual underpinning of the Companies Act of 2008 in a concessionary multi-stakeholder mould and conceding that the protection of multi-stakeholder interests is essential, the thesis argues that the Companies Act fails in its own injunction to adequately balance these interests. It fails to create a regulatory environment which allows for the following question continuously to be asked: Which stakeholder is most deserving of protection once the company, while indebted to various stakeholders, is in financial distress? The pendulum has swung in favour of employee interests despite additional protections specifically catering to the latter outside of company law. This approach potentially fails to recognise that during financial distress, it is the debtor's interests which are paramount even at the expense of all other interests. Once this interest is protected, all others benefit in consequence (whether in the short, medium or long term).³⁰ Observing the expansive nature of the mandate imposed by section 7(k), the critique is narrowed to an analysis of the manner in which Chapter 6 balances the diverse interests of the company's creditors when it enters business rescue proceedings.

1.4 OUTLINE OF RESEARCH

In pursuance of this objective, the thesis is structured as follows:

Chapter Two will discuss the nature of the corporation. In this discussion the chapter explores different theories attributable to the corporation and attempts to provide a response to the question of in whose interests the corporation should be managed.

Chapter Three provides a chronological and historical analysis of judicial management as a company rescue procedure. To this end, the thesis contextualises factors which are critical to the form and substance of judicial management as well as weaknesses inherent in the regime. It will be necessary to analyse the use and scope of the word 'creditor' as employed in the 1973 Act as well as the manner in which various competing interests were treated prior to and subsequent to the granting of a judicial management order.

Chapter Four will enter into a discussion of the 2008 Companies Act. In doing so, emphasis is placed on; (i) its broad objectives and what it seeks to achieve, (ii) business rescue provisions, focusing on the procedure, (iii) a specific analysis of the Act's provisions in relation to the treatment of creditors generally in comparison to the 1973 Act and (iv) a

³⁰ While the treatment of employee interests in Chapter 6 of the Act is one of the central aspects critiqued, it is by no means the only aspect given attention. Neither is it suggested that a dilution of this category of stakeholder's interests is the only intervention (or even a sufficient intervention) necessary for enhancing the regime's strength and its perceived attractiveness.

critical analysis of the manner in which the 2008 Companies Act balances creditor rights in the light of the broader purposes of the Act and the specific business rescue provisions.³¹

In analysing business rescue provisions, it is important to discuss the treatment of creditor interests at the pre- and post-commencement stages of the process. The chapter will further highlight a number of weaknesses which result in the new business rescue regime failing to balance multiple stakeholder interests in a manner that enhances the efficiency of the overall regime.

Chapter Five enters into a comparative analysis of the United Kingdom and the United States' respective approaches. The chapter highlights how these jurisdictions have dealt with the vexing issue of balancing creditor interest during insolvency or bankruptcy. It outlines specific features which have strengthened their respective rescue regimes. The chapter concludes with a comparison of these jurisdictions³² with South Africa, highlighting the differences in approach which may be preventing the South African regime from growing in strength as an efficient rescue mechanism.

Chapter Six concludes by a summary of the thesis' hypothesis. It considers whether more can be learnt and/or adopted by South Africa in order to better deal with the current challenges and weaknesses observed. Importantly, the chapter proposes legislative amendments which may facilitate a better balancing between the new Act's purpose provisions in section 7 with business rescue in Chapter VI of the same Act.

³¹ It is acknowledged that a 'right' is conceptually distinguishable from an 'interest'. For the purpose of the thesis, these terms are applied interchangeably.

³² In light of international instruments such as the UNCITRAL *Legislative Guide on Insolvency law*.

CHAPTER 2: NATURE OF THE CORPORATION

2.1. DEVELOPMENT OF THE CORPORATION: AN OUTLINE

The development of the corporation and corporation theory may be illustrated by the following diagram:

Era of the entrepreneur (First Phase)

Emphasis on private ownership. There is no separation between ownership and control.



Era of the Corporate Revolution (Second Phase)

The advent of the corporation and its emphasis on the distinction between ownership and control. The shareholder is perceived as the dominant (if not only) investor worthy of protection.



Era of the Stakeholder (Third Phase)

At this phase theories are characterised by an implicit and explicit acknowledgement of a broader range of interests at stake. The corporation is viewed as seeking to balance the interests of various 'stakeholders' as opposed to those of shareholders only.

2.2. INTRODUCTION

The corporation has proven to be one of the most successful inventions in legal history.¹ This success is evidenced by the fact that from the period evidencing a shift away from the individual entrepreneur towards the corporation as the critical legal and economic vehicle, its essence has been the subject of intense debate with a range

¹ It is observed that the word 'corporation' is used in the American context while 'company' finds application in many commonwealth countries including South Africa. The two terms are used interchangeably in this thesis. The terms specifically exclude the close corporation, which is regulated by the Close Corporations Act 69 of 1984. The exclusion is as a result of its peculiar and unique attributes. Due to the vast majority of literature emanating from the U.S. and for sake of consistency, I predominantly make reference to 'corporation' rather than 'company'. See Henry N. Butler, 'The Contractual Theory of the Corporation' (1989) 11 *George Mason University Law Review* 99.

of theories attempting to explain its nature.²

A discussion of theories attempting to explain the nature of the corporation offers the following insights: it provides both a contextual and historical background, the effect of which is to enhance knowledge of factors, which have played an influence in its inception as well as evolution. It also enables a prediction of the future trajectory of corporation law as a body of law and of the corporation as an economic unit and legal construct.

Despite the descriptions employed in the literature, often couched in terms of ‘purpose’, ‘objective’ or ‘duty’, an analysis of corporation theory communicates both the nature of the corporation as well as how its definition is often contingent on historical context, geographical location, prevailing cultural attitudes and politics. A discussion of the shift informs the various expectations capable of attaching to the corporation, thus enabling a formulation with a degree of self-awareness by the particular analyst or even the critical analysis of existing expectations. It also allows for an examination of the changing nature of the corporation from an internal view, in terms of the manner in which it views itself³, versus the array of imperatives and duties imposed by law.

For example, an organisation may have the singular goal of maximising the wealth of its shareholders (whatever this term is understood to mean). The legislature may, however, enact legislation compelling the corporation to consider the interests of a specific corporate constituency and to ensure that these interests are protected either within corporation law (e.g. by protecting the interests of employees during corporate rescue through legal provisions) or outside it (by enacting non-conflicting labour legislation which mandates the corporation to treat employees in a particular manner).

An analysis of the nature of the corporation further allows for a consideration of these aspects and for a value judgement to be reached regarding whether external legislative interference on the corporation is in fact justified (or justifiable) in light of prevailing political, economic or social pressures. Where the interference is considered to be justifiable an additional set of questions may be posed: Is it too little or too much, and who pays for the cost of the interference? It is only once this

² For further reading see William T. Allen ‘Our Schizophrenic Conception of the Business Corporation’ (1992) 14 *Cardozo Law Review* *infra*; Stephen Bottomley ‘Taking Corporations Seriously: Some Considerations for Regulation’ (1990) 19 *Federal Law Review* at 207.

³ It is acknowledged that despite being endowed with a legal *persona*, the corporation is not capable of ‘seeing’ itself as an ordinary person would. This conception of ‘self-perception’ occurs through its board of directors and in light of the wishes (in theory) of its shareholders. As a result, the assertion is not to be taken in its literal sense.

analysis has been completed that it is possible to begin to objectively consider the strengths and weaknesses of the regulatory framework applicable to corporations and determine the measures necessary to remedy observed weaknesses.

An additional question that may be posed is whether this understanding of the corporation is contingent on a determination of its public or private nature. If the public interest imperatives (to be discussed later) are accepted, those same imperatives apply whether such entity be a public or private corporation in legal form.⁴ The specific legal form of the corporation, in other words, does not negate the existence and importance of these imperatives.

Bottomley observes that a layered set of distinctions is drawn in liberal corporate theory.⁵ The first consists of a distinction between the individual and the group when considered through the lens of social, economic and political activity.⁶ The second is between the public and private realms of social and political life.⁷

These distinctions are relevant for two reasons: The first is that historically, traditional legal thought has tended towards a preference for individual and private interests over group and public interests.⁸ This may explain the emphasis on the entrepreneur and consequent development of the concept of the firm as a nexus of contracts between individual players. The second is that corporations do not neatly fit in the above distinctions. In certain instances corporations have been perceived as manifestations of individual agency and freedom (contractual theory) while in others they have been seen as creatures of the state, posing a threat to individual freedom

⁴ It is to be noted that 'public' in this sense relates to whether a corporation is able to freely trade its shares on the open market or not. Keay seems to adopt a different view, arguing that the corporation's imperatives and objectives may differ depending on whether the company is publicly or privately held. For further reading see Andrew Keay *The Corporate Objective: Corporations, Globalisation and the Law* (2011) United Kingdom: Edward Edgar Publishing. Easterbrook and Fischel argue that there are fundamental differences between closely held (i.e. private) and publicly held corporations, see Frank H Easterbrook and Daniel R Fischel 'Close Corporations and Agency Costs' (1986) *Stanford Law Review* 271.

⁵ Bottomley (1990) at 205.

⁶ Bottomley (1990) at 205.

⁷ Bottomley (1990) at 205.

⁸ Bottomley (1990) at 205.

(concession theory).⁹

This chapter provides an examination of prevailing theories of the corporation, depicting a shift in perceiving the corporation as merely an embodiment of a nexus of private contracts, towards recognition of the corporation as an entity possessing a degree of public interest imperatives. This enquiry is relevant in contextualising the need for reform in light of weaknesses highlighted in Chapter 1 and provides further context for understanding the prism through which our new company law regime is to be seen.

There is a burgeoning literature which canvasses the nature of the corporation.¹⁰ However, given the scope and objectives of this thesis, it is only necessary to examine the express purpose of the 2008 Act by way of the two models that were clearly uppermost in the minds of the drafters- the shareholder and stakeholder models.

Both models attempt to provide a theory of the corporation from an internal perspective and examine the nature of interests prioritised by the corporation's managers (from a corporate governance point of view). In examining this aspect, the chapter hopes to provide some insight into the different views on the role of the

⁹ On the economic theory of the firm, see Simon Deakin 'The Corporation as Commons: Rethinking Property Right' (2012) 37 *Queens Law Journal* 339. On contractual and concession theory, see Liam S O' Mellin 'Neither Contract nor Concession: The Public Personality of the Corporation' (2006) 74 *George Washington Law Review* at 202; Melvin A Eisenberg 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' (1999) 24 *Journal of Corporate Law Studies* 822; William T Allen 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo L. Review* 261, 264-65; Henry N. Butler 'The Contractual Theory of the Corporation' (1989) *Geo. Mason L. Rev.* at 100; M. Stokes 'Company Law and Legal Theory' in W Twining (ed), *Legal Theory and Common Law* (1986); Robert C. Clark 'Contracts, Elites and Traditions in the Making of Corporate Law' (1989) 89 *Columbia Law Review* 1703; Robert C. Clark 'Agency Costs Versus Fiduciary Duties' in *Principals and Agents: The Structure of Business* (J. Pratt & R Zeckhauser eds) (1985) Boston: Harvard Business School Publishing at 57; Daniel R. Fischel and Frank H. Easterbrook 'The Corporate Contract' (1989) 89 *Columbia Law Review* at 1418, see also Frank H. Easterbrook 'Managers' Discretion and Investors' Welfare: Theories and Evidence' (1984) 9 *Delaware Journal of Corporate Law* 540; N. Bowie 'A Kantian Theory of Capitalism' (1998) *Business Ethics Quarterly* 38 at 47. Benedict Sheehy 'Scrooge- The Reluctant Shareholder: Theoretical Problems in the Shareholder-Stakeholder Debate' (2006) 14 *Miami Business Law Review* at 230; Kellye Y. Testy 'Old Questions, New Contexts: Corporate Law in Emerging Nations' (1997) 17 *New York Law School Journal of International and Comparative Law* at 505.

¹⁰ For a historical analysis of the corporation, see Ulrike Malmendier 'Law and Finance at the Origin' (2009) 47(4) *Journal of Economic Literature* 1076. On the modern corporation, Charles R.T O'Kelley 'The Entrepreneur and the Theory of the Model Corporation' (2006) 31 *Journal of Corporation Law* 573; Robert C. Clark 'The Four Stages of Capitalism: Reflections on Investment Management Treatises' (1981) 94 *Harvard Law Review* at 561; Mark S. Mizruchi 'Berle and Means revisited: The governance and power of large US corporations' (2004) 33 *Theory and Society* 579; Pujo Committee [US Congress, House Banking and Currency Committee] *Investigation of Concentration and Control of Money and Credit* (Washington: U.S. Government Printing Office, 1913); Ida Tarbell *History of the Standard Oil Company* (1905) New York: McClure, Phillips; Adam Winkler 'Corporate Law or the Law of Business? Stakeholders and Corporate Governance at the End of History' (2004) 67 *Law & Contemporary Problems* 109.

corporation within a society. This internal perspective is relevant as it provides an outline of the nature of expectations and duties which exist within the corporation. Further, it also allows for discerning the impact of corporation law reforms at a practical level, for those forming part of its constituencies.

A conceptual link is drawn between the often-conflicting interests of the corporation's managers and shareholders, government and public interest imperatives. In discussing this aspect, the chapter provides a response to the question relating to the possible interest of a government in protecting the company and why this issue is a priority in a developing country. In summary, without a comprehensive mapping of the terrain, a critique of the nature of the corporation becomes impossible.

2.3. THEORIES OF THE CORPORATION

The seminal work of Berle & Means pioneered academic scholarship in the area of corporation theory.¹¹ Academic scholars, lawyers and economists alike have attributed various interpretations to their works. Due to their work having greatly influenced the growth of this area (as well as the different and often opposing theories which have developed as a result), it is only appropriate that they receive primary of consideration.

Placing the development of the corporation in the American context on a historical continuum, Berle & Means hypothesise the origins of the 'corporation as contract' theory of the corporation:

...Each corporate "charter" [i.e. the certificate of incorporation] was the product of a three-fold negotiation involving the state and the combined associates, and between the groups of associates acting for themselves. It was recognised as a "contract" and has been so consistently dealt with in American law. The classic statement (which does not bear analysis), envisaged the result as a contract between the corporation and the state, the stockholders and the corporation, and the stockholders *inter sese*.¹²

They describe factors that drove the economic revolution in the American context as follows:

Though its outline is still obscure, the central mass of the twentieth century American economic revolution has become discernible. Its driving forces are five: (1) immense increase in productivity; (2) massive collectivization of property devoted to production, with accompanying decline of individual decision-making and control; (3) massive dissociation of wealth from active management; (4) growing pressure for greater distribution of such passive wealth; (5) assertion of the individual's right to live and consume as the individual chooses.¹³

¹¹ Adolf A Berle & Gardiner C Means *The Modern Corporation and Private Property* revised ed (1967) New York: Harcourt, Brace and World Inc.

¹² Berle & Means (1967) at 121.

¹³ Berle & Means (1967) at xxv.

Berle & Means consider the corporation to have been pivotal as both an instrument and vehicle that has become a dominant form of organisation and production, capable of creating and distributing a passive form of wealth.¹⁴ They observe that despite the above, it remains constrained to follow norms embodied in social attitudes, case law, legislation and constitutional law.¹⁵ They further argue that:

Corporations are essentially political constructs. Their perpetual life, their capacity to accumulate tens of billions of assets, and to draw profit from their production and their sales, has made them part of the service of supply of the United States. Informally they are an adjunct of the state itself.¹⁶

This view may have served as the impetus for the corporation as concession theory as the corporation is viewed as an extension of the state not only because of the assets it is capable of acquiring or its perpetual succession but also because of the responsibilities and duties imposed; not only on shareholders but on broader society.

The writings of Berle & Means have been interpreted by some scholars as postulating a theory which focuses on the protection of the corporation's shareholder to the exclusion of its stakeholders. In light of the apparent disdain Berle & Means often expressed towards the corporation's managers (who they often referred to as its 'controllers'), this interpretation is not completely without foundation. However, there is nothing to suggest that they preferred a view emphasising shareholders' interests to the exclusion of the corporation's stakeholders.

Illustrating the extent to which conceptions of property and ownership have changed in the modern corporation, Berle & Means cite Rathenau¹⁷, who observes the form that the corporation had increasingly begun to take:

No one is a permanent owner...the depersonalization of ownership simultaneously implies the objectification of the thing owned. The claims to ownership are subdivided in such a fashion, and are so mobile, that the enterprise assumes an independent life, as if it belonged to no one; it takes an objective existence, such as in the earlier days was embodied only in state and church, in a municipal corporation, in the life of a guild or religious order...The depersonalization of ownership, the objectification of enterprise, the detachment of property from the possessor, leads to a point where the enterprise becomes transformed into an institution which resembles the state in character.¹⁸

Viewed from a socio-analytical prism, the corporation involves a wide diversity of economic interests consisting of 'owners' supplying capital, workers who create, consumers who give value to the products or services created as well as

¹⁴ Berle & Means (1967) at xxv.

¹⁵ Berle & Means (1967) at xxv.

¹⁶ Berle & Means (1967) at xxvi.

¹⁷ As cited in Berle & Means (1967) at 309.

¹⁸ Berle & Means (1967) at 309.

directors and managers who wield power within the organisation.¹⁹ Implicit in this argument is recognition that the corporation extends beyond the economic notion of the firm and its conception of the corporation as a nexus of contracts.

The combination of a great concentration of power as well as a diversity of interests within the corporation has resulted in the long-fought issue of power, the question of how best to regulate it as well as the protection of interests within the corporation.²⁰ Arguing that the corporation has extended beyond the maximisation of shareholder interest, Berle & Means constructed a fresh theory of the corporation. This theory views the relationship between shareholders and managers as no longer dialectical and conflicting but as co-existent in pursuing the furtherance of objectives distinct from either party. They further posit that

...the owners of passive property, by surrendering control and responsibility over the active property, have surrendered the right that the corporation should be operated in their sole interest...At the same time, the controlling groups, by means of the extension of corporate powers, have in their own interest broken the bars of tradition which require that the corporation be operated solely for the owners of passive property...The control groups have, rather, cleared the way for claims of a group far wider than either the owners or the control. They have placed the community in a position to demand that the modern corporation serve not alone the owners or the control but all society...When a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society...²¹

It is in this light that a discussion of the shareholder and stakeholder theories of the corporation must be considered. The theoretical vision of both theories extends the scope of the purpose of the corporation and provide important conceptual building blocks in constructing a theory of the corporation.

2.3.1.SHAREHOLDER THEORY

Shareholder theory proposes that the corporation exists to make money for shareholders.²² According to this view, it is made up of assets constituting private property which belong to its shareholders, as residual claimants, to the exclusion of

¹⁹ Berle & Means (1967) at 310.

²⁰ Berle & Means (1967) at 310.

²¹ Berle & Means (1967) at 312.

²² Laura Allsop 'Should Companies be Run Purely to Serve the Interests of Shareholders?' (2012) 1 *UK Law Students Review* 61. The terms 'shareholder value' or 'shareholder value maximisation' have often been alluded to in the literature, with varied arguments being posited with respect to how the concept is to be determined. See A Rappaport *Creating Shareholder Value* (1986) New York: The Free Press at 1; C Kirchner 'Shareholder Value: A New Standard for Corporation Conduct' in K. Hopt and E Vermeersch (eds) *Capital Markets and Corporation Law* (2003) Oxford: Oxford University Press at 343.

other parties.²³ As a result of the position of shareholders, they are viewed as the most appropriate constituency to decide on issues affecting the corporation.²⁴ Directors are seen as fiduciary agents who run the company on the shareholders' behalf.²⁵ Any action taken by directors to further interests other than those of shareholders would constitute a breach of trust. In short, the corporation is seen in terms of its members rather than as a separate entity.²⁶

Hansmann & Kraakman²⁷, observing the debates concerning the contract and concession theories of the corporation, posit a slightly different argument for shareholder theory as follows:

In our view the traditional debate between concession and contract theorists is simply confused. On the one hand, corporations - whether "concessions" or contracts - should be regulated when it is in the public interest to do so. On the other hand, the standard model is, in effect, an assertion that social welfare is best served by encouraging corporate managers to pursue shareholder interests.²⁸

Asserting the primacy of shareholder interest in corporate law in their view does not infer that stakeholder interests are not to be given any protection.²⁹ The assertion of shareholder interests entails that stakeholders (to the exception of the corporation's creditors) are best protected by measures outside of corporate law.³⁰

Creditors are seen as an exception to this proposition.³¹ The basis for this is that corporate law should directly regulate some of the aspects of the corporation and its creditors.³² Examples of this include piercing the corporate veil and limitations on the distribution of dividends where there is inadequate capital.³³

The concession made by Hansmann & Kraakman in favour of creditors as the

²³ Allsop (2012) at 61-62, see also F. Easterbrook and D. Fischel *The Economic Structure of Company Law* (1991) Cambridge Massachusetts: Harvard University Press at 36-9. Some have disagreed that the corporation's shareholders are the only residual risk bearers, see G. Kelly and J. Parkinson 'The Conceptual Foundations of the Company: a Pluralist Approach' in J. Parkinson, A. Gamble & G. Kelly (eds) *The Political Economy of the Company* (2000) Oxford: Hart Publishing; G. Garvey and P. Swan 'The Economics of Corporate Governance: Beyond the Marshallian Firm' (1994) 1 *Journal of Corporate Finance* at 140.

²⁴ Keay (2011) at 63.

²⁵ This position is in line with 'agency theory', which views managers as overseers of the voluntary negotiation of actors participating within the nexus, acting as agents of the corporation's shareholders. On this view shareholders are seen as best placed to guide and discipline directors carrying out their duties, thereby limiting shirking and other opportunistic behaviour. See T. Jones 'Corporate Social Responsibility Revisited Redefined' (1980) *California Management Review* at 61.

²⁶ Allsop (2012) at 61.

²⁷ Henry Hansmann and Reinier Kraakman 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439.

²⁸ Hansmann & Kraakman (2001) at 442-3.

²⁹ Hansmann & Kraakman (2001) at 442.

³⁰ Hansmann & Kraakman (2001) at 442.

³¹ Hansmann & Kraakman (2001) at 442.

³² Hansmann & Kraakman (2001) at 442.

³³ Hansmann & Kraakman (2001) at 442.

only group to be protected through corporate law, as opposed to other stakeholders, may face certain difficulties. This difficulty is visible where the corporate constituency of employees is taken as an example. The employee (ordinarily categorised as a ‘stakeholder’ rather than ‘creditor’) may be transformed into a creditor in respect of unpaid salaries where the corporation faces insolvency. The same employee may also be a shareholder in the corporation in question. This trend is seen in many corporations incentivising productivity through employee share schemes. It is in this regard that the view expressed by Hansmann & Kraakman potentially runs the risk of not sufficiently recognising (or give credence to) the often-fluid nature of interests in an organisation.³⁴

In addition to asserting the primacy of shareholder interests, Hansmann & Kraakman argue that shareholder theory asserts the interests of *all* shareholders, more especially minority shareholders as they require the most protection.³⁵ They list different models (either found to have failed or having lost their normative force), which were at different times in history considered as alternatives to the shareholder model as a way of depicting the ‘progression’ towards this model as both an appropriate and effective corporate governance mechanism.³⁶

These consisted of the manager-oriented, labour-oriented and state-oriented models. The manager-oriented model found greatest application in the United States from the 1930s to the 1960s.³⁷ It views the corporation’s managers as technocratic fiduciaries capable of serving the general public interest and a significant emphasis is placed on corporate social responsibility.³⁸ Hansmann & Kraakman argue that experience would later show that where managers were granted significant discretion, they would tend to further their own interests at the expense of the corporation.³⁹

The labour-oriented model emphasises the involvement of employees in corporate decision-making through their representation on the corporation’s board of directors.⁴⁰ This model was prominently advocated in jurisdictions such as Germany. After the Second World War more European countries began following Germany’s

³⁴ Some have argued that shareholders, when compared to the corporation’s stakeholders, are not as vulnerable as shareholder primacy theorists would like us to think. See Keay (2011) at 89; L. Stout ‘Bad and Not-So-Bad Arguments for Shareholder Primacy’ (2002) 75 *South California Law Review* at 1193.

³⁵ Hansmann & Kraakman (2001) at 442.

³⁶ Hansmann & Kraakman (2001) at 443.

³⁷ Hansmann & Kraakman (2001) at 444.

³⁸ Hansmann & Kraakman (2001) at 444.

³⁹ Hansmann & Kraakman (2001) at 444.

⁴⁰ Hansmann & Kraakman (2001) at 445.

approach, even if in diluted form.⁴¹ Hansmann & Kraakman argue that this style of management has fallen out of favour as a result of being associated with inefficient decision making, paralysis or boards that are considered weak.⁴²

The state-oriented model entails strong government involvement in the affairs of the corporation as a measure of ensuring that private businesses conduct their activities in line with public interest.⁴³ This involvement would serve to avoid deficiencies of the market. The model found most application in post-war France and Japan.⁴⁴ The State has a discretion regarding allocating credit and foreign exchange as well as exemptions and rules relating to competitive conduct.⁴⁵ Hansmann & Kraakman observe that the shift away from this model has been as a result of the shift away from State socialism as a political system and model.⁴⁶

Three forces have been described as instrumental in shareholder theory's normative popularity. These consist of the forces of logic, example and competition.⁴⁷ The force of logic posits four propositions, which are understood as having supported the shareholder theory of the corporation. The first is that the firm's investors cannot be adequately protected through contract and that their control over the firm serves as a measure of protection for both themselves and their investment.⁴⁸

The second is that if equity rights granted to the firm's investors are strong as well as exclusive, this will encourage shareholders to maximise the value of the firm.⁴⁹ The third is that the interest of the firm's stakeholders can generally be protected through contract, with this protection being deemed sufficient.⁵⁰ Where equity holders are able to maximise the firm's value, this factor is understood to impact on the firm's ability to respect its contractual obligations.⁵¹ The fourth is that where contract is inadequate to protect the firm's stakeholders, its governance structure may be adapted to counter such deficiencies.⁵² Significantly, it is suggested that the theoretical vision of the corporation influences economic performance.⁵³

⁴¹ Hansmann & Kraakman (2001) at 445.

⁴² Hansmann & Kraakman (2001) at 445.

⁴³ Hansmann & Kraakman (2001) at 446.

⁴⁴ Hansmann & Kraakman (2001) at 446.

⁴⁵ Hansmann & Kraakman (2001) at 447.

⁴⁶ Hansmann & Kraakman (2001) at 447.

⁴⁷ Hansmann & Kraakman (2001) at 449.

⁴⁸ Hansmann & Kraakman (2001) at 449.

⁴⁹ Hansmann & Kraakman (2001) at 449.

⁵⁰ Hansmann & Kraakman (2001) at 449.

⁵¹ Hansmann & Kraakman (2001) at 449.

⁵² Hansmann & Kraakman (2001) at 449.

⁵³ Hansmann & Kraakman (2001) at 450.

With the force of example, the view is advanced that common-law countries, and specifically countries which have applied shareholder theory, have been found to economically out-perform jurisdictions applying labour and state-oriented models.⁵⁴ The force of competition looks at the internationalisation of both product and financial markets and views this factor as one that has brought about competition between jurisdictions adhering to different models.⁵⁵ The view is that firms in jurisdictions applying shareholder theory have been characterised by access to equity capital at lower costs, development of new product markets, stronger emphasis on managerial coherence as well as rapid abandonment of inefficient investments.⁵⁶

The question has been posed whether the shareholders referred to by shareholder primacy theorists are only limited to current shareholders or are inclusive of future shareholders as well? Where the interests of future shareholders are to be considered, how are the directors of the corporation to balance between these interests?⁵⁷ Unfortunately, no definitive responses seem to have been provided prompting some to argue that shareholder maximisation theory is not sufficiently sophisticated to account for the diversified nature of the corporation's shareholders.⁵⁸ The conceptual debate has important implications on the question of the weighting of interests and the impact of this on the functioning of a business.

2.3.2. STAKEHOLDER THEORY

Stakeholder theory⁵⁹ provides an alternative approach to the purpose of the corporation.⁶⁰ It consists of aspects which are normative, descriptive and instrumental.⁶¹ The normative aspect considers the question of how those classified as stakeholders are to be treated.⁶² It views stakeholders as possessing inherent value and

⁵⁴ Hansmann & Kraakman (2001) at 450.

⁵⁵ Hansmann & Kraakman (2001) at 451.

⁵⁶ Hansmann & Kraakman (2001) at 451.

⁵⁷ It has been suggested that unlike shareholder and communitarian theories, stakeholder theory combines both economics and ethics in translating business ethics to management practice. For further reading see Y. Fassin 'The Stakeholder Model Refined' (2009) 84 *Journal of Business Ethics* at 113.

⁵⁸ See T. Smith 'The Efficient Norm for Corporate Law: A Neo-traditional Interpretation of Fiduciary Duty' (1999) 98 *Michigan Law Review* 214 at 217.

⁵⁹ Terminology such as 'stakeholder model', 'stakeholder framework' or 'stakeholder management' is often applied. It is to be noted further that different variations of the theory exist and are wide ranging in nature. For further reading see R. Edward Freeman 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4 *Business Ethics Quarterly* 409 at 413.

⁶⁰ Andrew Keay 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9 *Richmond Journal of Global Law and Business* 201 at 254.

⁶¹ Keay (2010) at 254.

⁶² Keay (2010) at 254.

thus deserving of consideration by the corporations directors in the performance of their duties.⁶³ This normative conception is construed as a legitimacy claim, which is at odds with the concept of shareholder primacy.⁶⁴

The theory's descriptive value is in its ability to explain corporate behaviour. The instrumental aspect examines how emphasis on the stakeholder impacts on the corporation's performance, efficiency and success.⁶⁵ It is premised on the notion that all parties who contribute to the corporation (thus having an influence on the creation of value within it) should benefit. In this way, stakeholder theory posits that corporations are managed for the benefit of and are accountable to all stakeholders.⁶⁶

Stakeholders are broadly defined as consisting of the corporation's customers, suppliers, financiers, creditors, shareholders, employees and local communities as well as tax authorities.⁶⁷ This is by no means the only definition provided for the term, neither is it exhaustive.⁶⁸ The theory generally does not endorse the prioritisation of one stakeholder's interests over another.⁶⁹ An exception does occur in instances where the inequality in question has the effect of improving the situation of the stakeholder most in need.⁷⁰ Even though stakeholders' interests may not be identical, this does not necessarily infer that they are not sometimes common.⁷¹ The theory also concerns itself with the damage that externalities may have on stakeholders.⁷² Externalities are described as:

...Occur[ing] when managers transfer the costs of the corporation to stakeholders and retaining resulting benefits for shareholders. This occurs, for example where a corporation makes workers redundant so that dividends can be paid to shareholders and the share price will increase.⁷³

Negative externalities may be seen in instances where the alleged insolvency of a company is used as a basis for retrenching employees in order to cut expenditure and increase profit. In the South African context this trend is often seen in companies that retrench their permanent employees on operational grounds only to subsequently

⁶³ Keay (2010) at 254.

⁶⁴ Keay (2010) at 254. For further reading see Bert Van de Ven 'Human Rights as a Normative Basis for Stakeholder Legitimacy' (2005) 5 *Corp. Governance* 48 at 51.

⁶⁵ Keay (2010) at 255.

⁶⁶ Keay (2010) at 256.

⁶⁷ Keay (2010) at 257.

⁶⁸ Keay (2010) observes that there was an average of twenty-five different definitions of the term 'stakeholder' between 1963 and 1995. For further reading see Ronald Mitchell *et al* 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 *Academy of Management Review* 853 at 855.

⁶⁹ Keay (2010) at 258.

⁷⁰ Keay (2010) at 258.

⁷¹ B. Ford 'In Whose Interest: An Examination of the Duties of Directors and Officers in Control Contests' (1994) 26 *Arizona State Law Journal* 91 at 101.

⁷² Keay (2010) at 256.

⁷³ Keay (2010) at 256.

employ the services of a third party labour broker in order to avoid duties imposed by labour legislation. As a normative theory, it requires managers to balance the interests of all stakeholders when making decisions.

In balancing stakeholder interests, it ought to be realised that while all stakeholders may be considered equal, not all claims or interests are equal in a given situation.⁷⁴ Keay argues that the role of managers is determining how to balance these interests in a situation, while focusing on the relative contribution of the respective stakeholders to the corporation.⁷⁵

Stakeholder theory has not been without criticism. It has been argued that the theory fails to define stakeholders of the corporation, fails to explain how directors are to balance the interests of stakeholders and lacks clarity.⁷⁶ It has also been criticised on the basis that it is generally impractical to apply and enforce.⁷⁷ Theoretical developments have occurred, where a ‘middle ground’ between the competing theories has been suggested. These have been in the form of progressive scholarship. I briefly consider this position next.

Progressive corporate scholarship advocates for the protection of the corporation’s stakeholders. However, instead of arguing for the protection of these corporate constituencies through corporate law, progressive corporate scholars advocate for the protection of this group through adjacent mandatory legal reforms.⁷⁸ These may take the form of laws regulating labour, workplace, securities and tax as well as civil rights.⁷⁹

Articulating the content and purpose of the duties imposed on corporate managers outside of corporation law, Clark argues:

If the legal system as a whole imposes so many duties to so many constituencies and thus mandates a wide ranging (though perhaps inadequate and not coherent) accommodation of diverse interests, what, if anything, is the real meaning of the profit maximizing norm? The answer is that it tells corporate managers what their residual goal is-or, in economic jargon, what the company’s “objective function” is. The duties to all other groups need simply be satisfied- they function as constraints but the duty to shareholders is open ended: Profits should be made as large as possible, within the constraints.⁸⁰

⁷⁴ Keay (2010) at 257.

⁷⁵ Keay (2010) at 257.

⁷⁶ Keay (2010) at 299.

⁷⁷ Keay (2010) at 299. A consideration of the various responses to these criticisms is unfortunately beyond the scope of this thesis.

⁷⁸ For further reading see Ralph Nader *Taming the Giant Corporation* (1976) New York: Norton.

⁷⁹ Winkler (2004) at 128. See Robert Charles Clark *Corporate Law* (1986) Boston: Little, Brown and Company.

⁸⁰ Clark (1986) at 678.

In his later work Clark observes that directors of a firm, at a practical boardroom level, are often primarily concerned with the enhancement of shareholder value and that other constituencies are kept content only to the extent necessary in order to achieve this objective.⁸¹ Reformulating shareholder primacy, he argues that legislators ought to consider the impact of the corporation on social welfare, rather than making this the responsibility of corporate boards.⁸² In this restatement of shareholder primacy, directors retain a fiduciary duty to maximise shareholder value but are subject to obeying the law as well as meeting legal obligations pertaining to non-shareholder constituencies.⁸³ In this way, directors ought to cause their corporations to respond to market, social as well as normative forces in a way that keeps non-shareholder constituencies optimally involved in the business of the corporation.⁸⁴

The legislative responsibility imposed would include consideration of the impact that corporations have on social welfare.⁸⁵ Because the determination of the optimum way to maximise this social welfare often involves much guessing and differing legislative interventions, it is best to be left to the legislature.⁸⁶ Despite observing the importance of shareholder value maximisation on the part of directors, he believes that there are limitations to which directors should be subject.⁸⁷

Mitchell⁸⁸ argues that viewing the corporation merely as a profit maximising machine is unrealistic. He applies Lon Fuller's⁸⁹ two models of human associations in constructing a theoretical typology for the corporation and observes the relevance of a shared associational principle in the context of the corporation as follows:

Each of the corporation's constituent groups takes part in the association in order to enhance its own financial wellbeing. To the extent that the corporation is organized around the shared

⁸¹ Robert C. Clark 'Major Changes Lead us Back to Basics (A Response to the Symposium on My Treatise)' (2006) 31 *Journal of Corporation Law* 591 at 596.

⁸² Clark (2006) at 596.

⁸³ Clark (2006) at 597. These constituencies include creditors, employees, suppliers, customers as well as taxing authorities.

⁸⁴ Clark (2006) at 597.

⁸⁵ Clark (2006) at 596.

⁸⁶ Clark (2006) at 596.

⁸⁷ Clark argues that legal obligations may be created in a variety of ways such as through the common law, contracts, statutes, rulings, case law and regulations. Due to the broad nature of these obligations, caveats to shareholder primacy are in this way seen as significant.

⁸⁸ Lawrence Mitchell 'Cooperation and Constraint in the Modern Corporation: An Inquiry into the Causes of Corporate Immortality' (1995) 73 *Texas Law Review* 477.

⁸⁹ Fuller asserts that human association is best described by two models or principles. The first is association based on the principle of shared commitment. This is characteristic of associations such as universities, religious or civic associations and the like. The second is organised around legal principle. It is characteristic of an emphasis on formality, structure, rules of duty and the like. See Lon L. Fuller 'Two Principles of Human Association' in *Voluntary Associations* in J Roland Pennock & John W Chapman (eds) (1969) New York: Atherton Press.

commitment of the pursuit of profit, it is more likely to be driven apart than bound by the fact that each group seeks to maximise its own profit. Because at some point the distribution of corporate wealth within the corporation is a zero-sum process, this profit maximization will be in competition with, and at the expense of, other groups.⁹⁰

He rejects the model of human association based on legal principles on the ground that the model does not view the corporation's role players as functioning human beings but rather as 'abstracted rule bound roles' consisting of stock-holders, officers and directors.⁹¹ The corporation is viewed as an entity with shared commitments and goals, which vary in nature with role players within it not merely competing for profits but engaging in a shared initiative to provide goods and services.⁹²

According to Mitchell, it is the identification of the common goal of a cooperative enterprise which is essential in determining its nature.⁹³ He criticises the goal of profit maximisation, which he sees as prevalent in the law, on the basis that it shifts the focus from a variety of other goals that the corporation may pursue as a collective enterprise.⁹⁴ This constraining effect in the law encourages immoral behaviour on the part of managers (among other corporate constituents) and possesses the potential to negatively affect the long-term success of the corporation.⁹⁵ A theory that views the nature and purpose of the corporation as solely that of maximising wealth for its shareholders imposes limitations on its moral ability to consider the effect of its conduct on others.⁹⁶ He posits that where the corporation is broadly defined to include the lives of those affected by its activities, it is enabled to internalise many of the issues considered to be external to it (such as its impact on employees, creditors, suppliers, customers and the community).⁹⁷

Mitchell observes that according to prevailing empirical evidence, corporations whose productive processes create intolerable externalities are ultimately made to account for them, until these corporations internalise these externalities. He accepts the possibility of his view being incorrect but argues that such a situation would be highly unlikely. Acknowledging the necessity of a more comprehensive theory explaining his position, he posits the second response as follows:

⁹⁰ Mitchell (1995) at 486.

⁹¹ Mitchell (1995) at 488.

⁹² Mitchell (1995) at 489.

⁹³ Mitchell (1995) at 489.

⁹⁴ Mitchell (1995) at 489.

⁹⁵ Mitchell (1995) at 490.

⁹⁶ Mitchell (1995) at 502.

⁹⁷ Mitchell (1995) at 503.

I believe that if corporate actors are left to their own devices in the society we currently have and have an awareness that society expects them to behave in a corporate context as complete members of that society, corporate actors on balance will behave well.⁹⁸

Whether one agrees with the optimism expressed by Mitchell in his second response, it cannot be denied that the insights he shares are critical to the construction of a theory of the corporation. Mitchell's theoretical model is consistent with the purpose provisions of the new Companies Act⁹⁹ as it broadly mandates the pursuance of goals extending beyond merely profit maximisation. This approach is, in turn, later compared to that of the U.S. Bankruptcy Code and U.K. Insolvency Act. I now turn to a discussion of the potential theoretical linkages that may be drawn from an analysis of the theories.

2.3.3. POSSIBLE THEORETICAL LINKAGES

The shareholder-stakeholder theory debate may be linked to Bottomley's layered distinctions in corporate theory considered earlier, particularly his first distinction.¹⁰⁰ The individual may be seen as a representation of the singular shareholder and the group as the body of the corporation's stakeholders.

An additional linkage may be drawn between Berle & Means' conception of relationships within the corporation and the corporation as concession and stakeholder theories. Berle & Means are at pains to emphasise a paradigm shift in thinking, in the form of an acknowledgement that the corporation can no longer be operated for the sole profitability of its shareholders.¹⁰¹ They affirm that the corporation has a duty to serve broader society as well.¹⁰²

If these suggested linkages are accepted, embedded in the public interest imperative conception of the corporation is the implicit acknowledgement of the critical role that law plays in economic development that promotes aggregate welfare. This economic development may arise as a result of legislative interventions, which impose barriers or create opportunities for both the corporation and its broader stakeholders. In this way, the corporation is also capable of serving as an instrument for this form of economic development.

As canvassed in the introductory chapter, this aspect may be seen in factors such as the corporation's ability to contribute to employment creation, its productive

⁹⁸ Mitchell (1995) at 536.

⁹⁹ Act 71 of 2008 at section 7.

¹⁰⁰ Bottomley (1990) at 205.

¹⁰¹ Berle & Means (1967) at 312.

¹⁰² Berle & Means (1967) at 312.

contribution to gross domestic product and its role as a revenue source for infrastructural development among others. The public interest imperative provides a justification for the regulation of the corporation and the imposition of welfare obligations upon it. From this premise (and if the corporation is accepted as possessive of a public interest dimension), corporation law, as a form of legislative regulation, ought to create an enabling environment for the corporation's fulfilment of these imperatives.

2.4. CONCLUSION

In summary, the role that the corporation plays in economic development has provided justification for the imposition of regulatory norms for the achievement of socio-economic imperatives.¹⁰³ The financial state of a corporation has a profound effect on the environment in which it operates, to its stakeholder base as well as the general economy. It is this public aspect of the corporation that necessitates both governmental intervention and protection, not merely because of the fact of legislative incorporation but because it is an association with public obligations.¹⁰⁴

There is an alternative justification for regulation. This recognises the value of all of the corporation's stakeholders as a necessary concomitant for the competitiveness of the corporation.¹⁰⁵ While managers rarely engage personally with shareholders, they often have to deal with employees (for example in relation to wage disputes), suppliers (in relation to supplies), customers (in relation to goods or services provided) and communities (in relation to initiatives such as corporate social

¹⁰³ On corporation law and economic development, see Alexander L Wiener Jr 'Law and Economic Development' (1963) 40 *University of Detroit Law Journal*; Riggs 'Economic development and Local Administration: A study in Circular Causation' (1959) 3 *PHIL J. Pub. Ad.* 86; Troy A. Paredis 'Corporate Governance and Economic Development' (2005) 28 *Regulation* at 36; John K M Ohnesorge 'Law and Development Orthodoxies and the North East Asia Experience' (2012) Gerald Paul McAlinn & Caslav Pejovic (eds) available at <https://law.wisc.edu/profiles/pubs.php?iEmployeeID=184>; Buchanan & Ellis *Approaches to Economic Development* (1955) New York: Twentieth Century Fund at 83; John Ohnesorge 'Legal Origins and the Tasks of Corporate Law in Economic Development: A Preliminary Exploration' (2009) *Birmingham Young University Law Review* 1619 at 1625; Kenneth Dam (2006) *The Law-Growth Nexus: The Rule of Law and Economic Development* Brookings Institution Press; Mark J. Roe & Jordan I. Siegel 'Finance and Politics: A Review Essay Based on Kenneth Dam's Analysis of Legal Traditions in The Law-Growth Nexus' (2009) 47: 3 *Journal of Economic Literature* 781; Antonio Estache & Liam Wren-Lewis 'Toward a Theory of Regulation for Developing Countries: Following Jean-Jacque Laffont's Lead' (2009) 47:3 *Journal of Economic Literature* 729 at 731; Silvia Ayuso *et al Maximising Shareholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance* (IESE Business School, University of Navarra, 2007) Working Paper No. 670.

¹⁰⁴ Ayuso (2007) at 3.

¹⁰⁵ Keay (2008) at 265.

investment).¹⁰⁶

Which theory guides regulation best? If it is accepted that shareholder theory encounters conceptual difficulties in balancing between present and future shareholders' interests (as observed by the theory's critics), how is the theory to account for the vast nature of (often) conflicting stakeholder interests that may be faced by the corporation?¹⁰⁷ Paredis¹⁰⁸ provides a possible response to the latter question. Citing Delaware Corporation law as a case study, he highlights the law of fiduciary duties as instrumental in resolving this issue. He further argues that a well-developed body of case law which makes fiduciary duty obligations less open ended, as well as a sophisticated judiciary respected in business and legal fraternities, which enforces obligations within the framework of shareholder supremacy, are important features.¹⁰⁹ Paredis considers the shareholder primacy norm to be essential in protecting shareholders not only against management-director abuses of power but also in balancing constituency interests that may conflict with the goal of maximising value for the firm.¹¹⁰ Stakeholder theorists have, in turn, placed emphasis that the interests of stakeholders in most need are to be granted primacy.¹¹¹

If it is accepted that all other interests are secondary or incidental to the sole mandate of shareholder wealth maximisation (however this term is construed), how are creditor interests, whose contribution to the corporation is often critical for its survival, to be balanced? What value do we attach to the interests of this group of stakeholders? What of employees, whose contribution is essential for the practical and efficient functioning of the corporation?

If shareholder theory is accepted as capable of considering these aspects (even if incidentally), at which stage would the reconciliation of competing interests become possible? What are the likely implications for the theory? It is my view that shareholder theory fails to adequately account for the multifaceted nature of interests in the corporation and cannot provide a reconciliation of these various interests. This position is important within the context of the introductory analysis engaged in earlier as well as in the analysis of the Companies Act of 2008.

¹⁰⁶ Keay (2008) at 265.

¹⁰⁷ An example is that of cost cutting to improve the bottom-line in the short-term while having potentially disastrous results in the long term. For further reading see E. Orts 'The Complexity and Legitimacy of Corporate Law' (1993) 50 *Washington Law Review* at 1592.

¹⁰⁸ Paredis (2005) at 34.

¹⁰⁹ Paredis (2005) at 35.

¹¹⁰ Paredis (2005) at 35.

¹¹¹ As discussed earlier.

The above theoretical debates inform the paradigm through which the purpose provisions of the Companies Act have received discussion in the introductory chapter. They further provide a framework through which the analysis of Chapter 6 of the Companies Act of 2008 proceeds and how the latter's critique develops in subsequent chapters. The orientation of both the Act's purpose provision and its Chapter 6 find greater theoretical support in stakeholder theory and this approach is broadly supported. However, the conceptual weaknesses highlighted in the introductory chapter cannot be ignored and must be addressed.

Despite the call for reform, it is recognised that the often divergent interests which come to the fore during financial hardship cannot simply be wished away. A successful company rescue regime will entail adaptation to a unique economy and country-specific attributes as well as a balance where the terrain is often unclear and muddy. It is for our purposes important to explore the extent (if at all) to which the previous regime responded to these challenges as insights gained therein will strengthen the conceptual foundations upon which our new business rescue regime will be critiqued. It is in this light, that the previous judicial management regime is discussed in the next chapter.

CHAPTER 3: JUDICIAL MANAGEMENT

3.1. INTRODUCTION

An analysis of the judicial management regime, its short-comings as well as an exposition of parallel developments in the area of Insolvency law and Labour legislation is critical to the proper critique of the Business Rescue regime in chapter 6 of the Companies Act of 2008.

This chapter begins by discussing the history of judicial management, contextualising the objectives that the system was designed to achieve. Legislative changes preceeding and leading up to the Companies Act of 1973's judicial management provisions are outlined. Thereafter, the chapter discusses the following: Requirements for initiating judicial management, the effect of the regime on subsisting contracts, treatment of creditors, linkages between the 1973 Act and Insolvency Law in relation to employees. The chapter will conclude with a discussion of the grounds on which proceedings may be terminated as well as criticisms levied against judicial management.

3.2. HISTORY OF JUDICIAL MANAGEMENT

The first company legislation in South Africa was in the form of the Cape Joint Stock Act.¹ This legislation substantially adopted the provisions of its English counterpart.² These pieces of legislation had already been repealed in the United Kingdom, at the time of their adoption in South Africa.³

Judicial management was introduced into South African company law by the Companies Act 46 of 1926.⁴ The impetus behind judicial management is succinctly captured in the following lines:

A developing economy cannot lightly permit companies which help to comprise its industries and commercial enterprises to be dissipated by winding up and dissolution due to some temporary setback in cases where there is a reasonable probability that they would, if granted a moratorium, be able to overcome their difficulties, discharge their debts and become successful concerns.⁵

¹ Cape Joint Stock Act Companies Limited Liability Act of 1861.

² The English Joint Stock Companies Act of 1844 and the Limited Liability Act of 1855. See H. S. Cilliers *et al Corporate Law* (2000) 3 ed Durban: Lexis Nexis Butterworths at 23.

³ Cilliers *et al* (2000) at 23.

⁴ A.H. Olver *Judicial Management in South Africa: Its Origin, Development and Present Day Practice and a Comparison with the Australian System of Official Management* (PhD thesis, University of Cape Town 1980) at 2.

⁵ Henning 'Judicial Management and Corporate Rescues in South Africa' in *Rajak Insolvency Law: Theory and Practice* (1993) London: Sweet & Maxwell 303-04. The purpose of judicial management was further articulated in *Silverman v Doornhoek Mines Ltd* 1935 TPD 349 where it was held that the purpose of judicial management was to enable companies who found themselves in dire straits, to have sufficient breathing space so as to be more successful concerns.

The Act emulated the provisions of the Transvaal Companies Act of 1909, which in turn had substantially adopted the provisions of the English Companies (Consolidation) Act of 1908.⁶ When the Bill was tabled in Parliament in 1923, the following comments were made:

...these sections are derived from the practice in England and America under which receivers in equity were appointed, in the case of an important concern in regard to which there is some fear that it will go into liquidation; one which can pay its debts and which can be helped by someone officially appointed for this purpose...⁷

The then Minister of Justice observed:

You might have a large wool factory getting into difficulties and which ought to be helped because it is an *institution which helps the country*. Then your court could intervene, when it is shown that this concern is [in]solvent, and thus help it through its difficulties...The concerns you would like to help with this power are industrial concerns such as factories manufacturing articles in South Africa. You might be able to help a few of these concerns out of the mire of the times.⁸

The Companies Act of 1926 introduced a regime designed to step back from the automatic winding up of a struggling company.⁹ The procedure would, provided that certain conditions were met, supersede a winding-up even where it would ordinarily have been just and equitable to do so.¹⁰ After the enactment of the 1926 Act, a number of amendments were incorporated.¹¹

On the 14 October 1963 the Van Wyk de Vries Commission was appointed to engage in an enquiry into the efficacy of the Companies Act as well as make recommendations on the further amendment of its provisions.¹² The terms of reference for the commission were *inter alia* as follows:

- (1) To consider what major amendments are required in law relating to the constitution, incorporation, registration, management, administration and winding up of companies and other associations, and matters incidental thereto...¹³

⁶ Cilliers *et al* (2000) at 23.

⁷ House of Assembly Debates vol 6 1926-02-25 col 996-997 as cited in Olver 'Judicial Management- A Case for Law Reform' (1986) 49 *THRHR* at 84.

⁸ My emphasis. Olver (1986) at 84.

⁹ Olver (1980) at 4.

¹⁰ Olver (1980) at 4.

¹¹ Harry Rajak and Johan Henning 'Business Rescue for South Africa' (1999) 116 *SALJ* 262 observe that while the process, from its inception in the 1926 Companies Act did not include a moratorium on the claims of creditors, it was through the Amendment Act 11 of 1932 that this protection was added for the debtor company. They note that this, in turn, had been inspired by the Great Depression of the 1930s.

¹² Van Wyk de Vries Commission of Enquiry into the Companies Act: Main Report (RP 45 of 1970). See also Companies Amendment Act 23 of 1939 and Companies Amendment Act 46 of 1952 which had been recommended by the earlier Millin Commission. The latter commission had reported an increase in the number of companies incorporated, where a growth in registrations from 7 852 companies in November 1935 to 32 000 by July 1948 was observed. The de Vries Commission at 1, commented on this aspect in the following: '...If these figures in 1948 were considered to constitute an enormous increase, the statistics covering the period since 1948 and up to the present must be considered to be startling...' See further Olver (1980) at 9-10.

¹³ Van Wyk de Vries Commission report (1970) at 1.

The commission's terms of reference were very wide, providing sufficient lee-way for it to introduce a number of reforms. Due to weaknesses which were found to affect the efficacy of the Companies Act of 1929¹⁴, the recommendations effectively resulted in the commission virtually drafting a new Companies Act¹⁵:

The commission was of the view that the exercise of attempting to incorporate amendments into the Act, as previous commissions had attempted to do, would simply have contributed to further complexity and uncertainty. In relation to judicial management, a number of criticisms were observed. The Masters of the Supreme Court argued that from a statistical perspective, judicial management only succeeded in a small number of cases.¹⁶ The view was that companies which should not have been placed under judicial management were often so placed and the procedure was often abused, inevitably resulting in the winding-up and dissolution of companies.¹⁷ At the time an order was granted, courts relied too heavily on the view of the applicants in relation to the company being able to become a successful concern.¹⁸ The commission observed that even at the stage when the order was granted, there was no proper and reliable assessment of the company's prospects of rehabilitation.¹⁹

It was the view of the Commission that the interests of the company's creditors ought to be decisive.²⁰ It was further recommended that immediately after the Master's appointment of the provisional judicial manager, a meeting of creditors and debenture holders be summoned in order to determine whether it would be advisable for the company to be placed under judicial management, as well as whether the company had reasonable prospects of becoming a successful concern.²¹

¹⁴ A number of observations were made. This included the observation that the Transvaal Companies Act of 1909 was found to have been enacted without due regard to differences between South African Company Law and its British counterpart, resulting in the legislative provisions being inconsistent with the South African common law. Our legislation equated institutions and functionaries in England with those in South Africa without accounting for differences. The latter point is illustrated by example at 5: '...E.g. some provisions in our Act are less effective because the original corresponding provisions in the English Act rely for their effectiveness on the existence and function of the Board of Trade in England. There is no such body in South Africa. In cases where the Board of Trade has been equated with our Minister or our Registrar or even our Master of the Supreme Court, the results have not been satisfactory...'

¹⁵ Van Wyk de Vries Commission report (1970) at 5.

¹⁶ Van Wyk de Vries Commission report (1970) at 145.

¹⁷ Van Wyk de Vries Commission report (1970) at 145.

¹⁸ Van Wyk de Vries Commission report (1970) at 145; RC Beuthin 'A Legislation: The Report of the Company Law Commission' (1970) *Annual Survey of South African Law* 246 page 268; see further Olver (1980) at 13.

¹⁹ Van Wyk de Vries Commission report (1970) at 146.

²⁰ Van Wyk de Vries Commission report (1970) at 146.

²¹ Van Wyk de Vries Commission report (1970) at 146; Beuthin (1970) at 268.

This was cited as a critical component of the recommendations.²² Despite its weaknesses, the question regarding whether to abandon the rescue regime remained contested terrain.²³ Judicial management was retained in the subsequent Companies Act.²⁴ Having provided a brief outline of the historical aspect and context of the 1973 Act, a discussion of the 1973 Act's provisions relating to judicial management follows.

3.3. RELEVANT PROVISIONS

For the purposes of this part of the chapter, it is important that the definition of judicial management be discussed for two reasons. The first is that it allows for a purposive interpretation of judicial management as a rescue regime.²⁵ The second is that it provides insight into the thresholds that had to be met in order for a company to have recourse to judicial management.

Unlike the concept of 'business rescue', which is defined in the Companies Act²⁶, judicial management was not defined in the Companies Act of 1973. Shrand²⁷ describes judicial management as a temporary respite granted by the court to an ailing company in order to enable it to overcome its financial difficulties, placing such a company in the hands of a third party specifically appointed for this purpose.

Burdette²⁸ describes judicial management as a mechanism that may be used by a company finding itself experiencing a temporary financial set-back due to either mismanagement or what the Act refers to as 'any other cause'.²⁹ The purpose of the mechanism is to restore the company to financial health.³⁰ The struggling company's

²² Beuthin (1970) at 269.

²³ This aspect is evident in the commissions main report see Main Report of the Companies Act Commission of Enquiry RP 45 1970 chapter xx p 145 para 51.02 where it is stated: 'The Masters of the Supreme Court have all urged the Commission to recommend the abolition of judicial management. They have submitted that the statistics prove that judicial management has been successful in only a small percentage of cases and that in many instances it should never have never have been resorted to. Furthermore, that the system of judicial management is being abused and that it proves to be the first step in an inevitable succession of events leading to the winding-up and ultimate dissolution of the company.'

²⁴ Companies Act 61 of 1973.

²⁵ Such discussion links with the historical background briefly discussed above.

²⁶ Companies Act 71 of 2008.

²⁷ David Shrand *The Law and Practice of Insolvency Winding-Up of Companies and Judicial Management* (1977) Juta Publishers at 326.

²⁸ DA Burdette 'Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)' (2004) 16 *South African Mercantile Law Journal* 241.

²⁹ Burdette (Part 1) at 246. See further section 427 of the Companies Act of 1973.

³⁰ Burdette (Part 1) at 246.

existing management is replaced with a judicial manager tasked with restoring the company to profitability.³¹

Loubser³², applying a creative approach to defining judicial management, considers the contents and requirements of both the provisional and final judicial management orders and reaches a conclusion similar to that of Burdette.³³ In describing judicial management Loubser notes the following:

...One has to rely on the requirements for and contents of both a provisional and final judicial management order to explain its nature and purpose. Essentially, a judicial management order vests the management of an unsuccessful company in a judicial manager under the supervision of the court, and divests the persons currently managing the company of their powers of management...³⁴

She further describes the vesting of management in a third party as well as a divestiture of powers of persons who are in current management of the company as incidences of judicial management. Judicial management only recognised the rescue of the company itself rather than its business.³⁵

3.4. REQUIREMENTS FOR JUDICIAL MANAGEMENT

The circumstances under which a company may be placed under judicial management read as follows³⁶:

- (1) When any company by reason of mismanagement or for any other cause—
 - (a) is unable to pay its debts or is probably unable to meet its obligations and
 - (b) has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or meet its obligations and become a successful concern, the Court may, if it appears just and equitable, grant a judicial management order in respect of that company.³⁷

The provision may be distilled as follows:

- (i) By reason of mismanagement;
 - (a) The company is unable to pay its debts or meet its obligations;
 - (b) The company is prevented from becoming a successful concern;
- (ii) A reasonable probability that if placed under judicial management, the company will become a successful concern;
- (iii) It is just and equitable that the order be granted.

³¹ Burdette (Part 1) at 246.

³² Anneli Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD Thesis University of Pretoria 2010).

³³ Loubser (2010) at 17.

³⁴ Loubser (2010) at page 17.

³⁵ As will be expounded upon later in the chapter.

³⁶ Companies Act 61 of 1973.

³⁷ Companies Act 61 of 1973, section 427(1).

These five aspects are relevant where a judicial management order is to be granted by court and are discussed in turn.

3.4.1. BY REASON OF MISMANAGEMENT

In relation to the phrase ‘by reason of mismanagement’ Loubser³⁸ observes the following:

The second part of the general proviso, namely that the reason for the company’s problems could be mismanagement or any other cause, derives from the wording of the original provisions dating from 1926. However, in terms of s 195(1) of the Companies Act of 1936, mismanagement on its own constituted a ground for judicial management. That is not the case under the present Act. In the Companies Act of 1973 the reference to mismanagement thus appears to be completely unnecessary and meaningless, given the fact that no particular or special reasons for the financial predicament of the company are required. Instead, the section clearly states that ‘any other cause’ is acceptable.³⁹

Meskin *et al* put forward the view that a significant number of cases decided under the corresponding provisions of the 1926 Act were based on the principle of non-interference on the part of the courts in the internal workings of a company.⁴⁰ As a result, judicial management was viewed by the courts as inappropriate where difficulties faced by the company were attributable to disputes between those controlling it.⁴¹ They raise doubts as to whether this approach gave effect to legislative intention and argue that the court in terms of section 472(1) was vested with the power to grant a judicial management order, irrespective of the cause of the company’s financial woes.⁴²

Cilliers *et al*⁴³, argue that the cause of the temporary financial set-back may have been ‘mismanagement or *other special circumstances*’.⁴⁴ It is not clear whether the authors envisage mismanagement as a separate test or whether they are simply making reference to the relevant section. In *Western Credit*⁴⁵, commenting on this

³⁸ Anneli Loubser ‘Judicial Management as a Business Rescue Procedure in South African Corporate Law’ (2004) 16 *South African Mercantile Law Journal* 136.

³⁹ Loubser (2004) at 142.

⁴⁰ Meskin *et al Henochsberg on the Companies Act 61 of 1973* online available at: <http://www.mylexisnexis.co.za.ezproxy.uct.ac.za/Index.aspx> accessed on the 30 October 2015 at 925.

⁴¹ Meskin *et al* op cit note 42 at 925.

⁴² Meskin *et al* op cit note 42 at 925. The authors do, however, concede that the cause is relevant for the purposes of identifying the chances of the company achieving the goals of the section. As a result, irreconcilable differences between directors may point to the probability of success being remote.

⁴³ Cilliers *et al* (2000) at para 26.01.

⁴⁴ My emphasis. See Harry Rajak *Insolvency Law Theory and Practice* (1993) London: Sweet & Maxwell at 305. In defining the purpose of judicial management Rajak also makes use of the term ‘or other special circumstances’.

⁴⁵ *Lief v Western Credit (Africa) (Pty) Ltd* 1966 (3) SA 344 (W) at 348.

phrase, the court distinguished between instances where a judicial management order would be granted as opposed to an order for liquidation:

A winding-up order is usually granted where a company is in fact insolvent, whereas a judicial management order is usually granted where a solvent company has run into financial difficulties because of mismanagement and because there is hope that with better management it will overcome its difficulties...

Even though the section applies the words ‘by reason of’, implying a causal link between mismanagement and the financial hardship consequently suffered by the company, the words ‘or for any other cause’ render the perceived requirement for the existence of mismanagement to be superfluous.⁴⁶

3.4.2. INABILITY TO PAY DEBTS

The company must be unable to pay its debts or meet its obligations.⁴⁷ Therefore in order to have recourse to the judicial management provisions of the Act, the company must be commercially insolvent.⁴⁸ Commercial insolvency would have to be proven by the applicants.⁴⁹

Due to the 1973 Act not having defined the word ‘obligations’, it has been suggested that the granting of an order for judicial management required proving to the court that the company was in fact unlikely to be able to meet its obligations in future.⁵⁰ Olver seems to be in agreement with this interpretation, arguing that the inability to pay debtors would also include the future inability of a company to perform a contractual obligation as opposed to the mere payment of a debt.⁵¹

Loubser has narrowed the temporal aspect, advancing the view that the future being referred to must either be immediate or foreseeable.⁵² This has an effect on the moment at which a company can apply for judicial management, and consequently its

⁴⁶ It is to be noted that no reference is made to ‘special circumstances’ in section 147 as argued by Cilliers *et al*, which would lead one to conclude that no causal link between the conduct of management and the poor financial state of the company need be proven.

⁴⁷ Companies Act of 1973, section 427.

⁴⁸ Loubser (2004) at 143 views the inability to meet obligations as an alternative to the inability on the part of the company to pay its debts; Loubser *South Comparative Aspects to Corporate Rescue in South African Company Law* (LLD dissertation 2010 Unisa) at 22. The authors in *Henocheberg on the Companies Act 61 of 1973* at 926 argue that the provisions of section 345 would be inapplicable in this context but concede that the inability could extend to obligations beyond the simple payment of a debt.

⁴⁹ *Bahnemann v Fritzmore Exploration (Pty) Ltd* 1963 (2) SA 249 (T) at 251; *Ben-Tovim v Ben-Towim and Others* 2003 (3) SA 325 (C) at 331; *Porterstraat 69 Eiendomme (Pty) Ltd v PA Venter Worcester (Pty) Ltd* 2000 (4) SA 598 (C).

⁵⁰ Loubser (2010) at 22.

⁵¹ Olver (1980) at 50.

⁵² Loubser (2010) at 22.

perceived chances of survival or restoration to solvency once proceedings have commenced.

Even though a discussion of this aspect may seem purely academic at this stage⁵³, it remains relevant. The stage at which a corporation is able to have recourse to the protective mechanisms of a rescue regime often determines the probability of the process being successful.⁵⁴ In the 2008 Companies Act, this aspect is clearly illustrated by the test of 'financial distress' read with the Act's 'reckless trading' provisions.⁵⁵ The test for 'financial distress' is forward looking. This aspect is comprehensively canvassed in Chapter 4.

3.4.3. SUCCESSFUL CONCERN

The 1973 Act did not indicate instances and circumstances where the company can be said to be 'prevented from becoming a successful concern'.⁵⁶ Many questions remained regarding the purpose of this provision as well as what it was intended to achieve. Loubser argues that the vagueness of the phrase added difficulty to proving all requirements for judicial management.⁵⁷ She however raises the possibility of an alternative interpretation:

By contrast, the requirement could be an important and sensible *alternative* to the first requirement (albeit with some amendments to the wording), in that a company which is still able to pay its debts and to meet its obligations but obviously struggling to do so and probably heading for disaster (and clearly qualifying as a concern which is not successful), could be placed under judicial management at a time when its chances of being rescued are far better than they would be when the company reaches commercial insolvency.⁵⁸

It is a requirement that it be further shown that upon the judicial management order being granted, the company will be capable of becoming a successful concern.⁵⁹ The enquiry in terms of the provision is whether the company would be enabled to (i) become a successful concern if it is placed under judicial management and whether (ii) it is just and equitable to grant the order.⁶⁰ It has been held that a provisional order may not be used as a 'fishing mechanism' for determining whether the company will in fact become a successful concern.⁶¹ The word 'will' in section 432(2) has been

⁵³ In light of the new Companies Act of 2008.

⁵⁴ Pieter Kloppers 'A Corporate Rescue Mechanism in Need of Reform?' (1999) 10 *Stellenbosch Law Review* at 431.

⁵⁵ Companies Act 71 of 2008, section 128 read with section 22(1)&(2).

⁵⁶ Companies Act of 1973, section 427 (1)(b).

⁵⁷ Loubser (2004) at 144.

⁵⁸ Loubser (2004) at 144.

⁵⁹ Companies Act of 1973, section 427 (1).

⁶⁰ Cilliers *et al* (2000) at 481.

⁶¹ See *Noordkaap Lewnhawe Ko-operasie Bpk v Shreuder en 'n Ander* 1974 SA 102 (A) at 110; *Kotze v Tulryk Bpk* 1977 (3) SA 118 (T) at 120.

described as requiring the applicant to provide proof of virtual certainty that the company will become a successful concern.⁶² The company was required to be able to pay its debts or meet its obligations and become a successful concern within a reasonable time.⁶³ The courts have, however, not sought to attach a specific time frame as to what would constitute a reasonable time and it is submitted that its determination would depend on the circumstances of the case.

3.4.4. REASONABLE PROBABILITY

The Court has discretion whether or not to grant the order for judicial management.⁶⁴ Cilliers *et al* argue that the requirement of a reasonable probability that the company be able to pay its debts or meet its obligations as well as become a successful concern only applied at the phase where the provisional judicial management order is sought.⁶⁵ In their view, on the return day the applicable test would simply be whether the company would be enabled to become a successful concern if placed under judicial management and whether the balances of justice and equity favour this.⁶⁶ They view this test⁶⁷ as more stringent than one of ‘reasonable probability’, which they argue finds application at the provisional order stage. Their basis for this view is that on the return day, the court is in a better position to judge the company’s prospects.⁶⁸ As will be observed from a discussion of case law below, the applicable test has received conflicting views from the courts.

In *Weinberg and Another v Modern Motors*⁶⁹ the court cautioned that a determination as to whether a reasonable prospect exists constitutes a finding of fact based on the information before it. A confident hope as expressed in affidavits without concrete evidence was found to be insufficient.⁷⁰

The court in *Tenowitz and another v Tenny Investments*⁷¹, per Smalberger J (as he then was), said:

⁶² Loubser (2004) at 144. The content of this section has received conflicting interpretations in the *Tenowitz* and *Ex parte Onus* cases *supra*.

⁶³ See *Irvin and Johnson v Oelofse Fisheries Ltd* 1954 (1) SA 231 (E) at 237.

⁶⁴ Companies Act of 1973 section 427. See generally *Maynard v Office Appliance SA (Pty)(Ltd)* 1929 WLD 290.

⁶⁵ Cilliers *et al* (2000) at para 26.10.

⁶⁶ Cilliers *et al* (2000) at para 26.10.

⁶⁷ That the company will become a successful concern.

⁶⁸ Cilliers *et al* (2000) para 26.10. Despite their view regarding the stringency of the applicable test, they however note the conflicting approaches in case law.

⁶⁹ *Weinberg and Another v Modern Motors (Cape Town) Pty Ltd* 1954 (3) SA 998 (C).

⁷⁰ *Weinberg supra* at 390.

⁷¹ *Tenowitz and another v Tenny Investments (Pty) Ltd supra*.

The test to be satisfied before a final judicial management order is granted is therefore a more stringent one than applies to the granting of a provisional judicial management order. The test propounded by section 432 of the Act for the granting of the final judicial management order is also more stringent than that under the s 195 of the old Companies Act 46 of 1926 which only postulated the reasonable probability test. The use of the word ‘will’ in s 432 of the Act would seem to suggest that there must be *a strong probability* amounting to a near certainty that the company will become a successful concern...⁷²

A different approach has been followed in other cases. In granting a final judicial management order it has been held that the essential question for the purposes of section 427 is whether the company is in fact capable of a reasonable chance of recovery with judicial management.⁷³ The Appellate Division⁷⁴ subsequently confirmed a reasonable probability as the applicable test.⁷⁵ It held that a reasonable possibility was insufficient to warrant the granting of the final order for judicial management.⁷⁶

⁷² My emphasis. At 683.

⁷³ *Guttman v Sunlands Township (Pty) Ltd* 1962 (2) SA 348 (C) 351-52. See *Ex parte Onus (Edms) Bpk supra*. In this case the court, per LC Steyn J (as he then was) concluded that the requirement to be met in seeking to obtain a final judicial management order did not differ from that required in obtaining a provisional order. See further *Du Plooy v Onus (Edms) Bpk* 1980 (4) SA 63 (O); *Kotze v Tulryk Bpk supra*; *Ladybrand Hotel (Pty) Ltd v Segal* 1975 (2) SA 357 (O).

⁷⁴ *Noordkaap Lewendehawe Ko-op Bpk supra* at 109-110.

⁷⁵ *Ibid.*

⁷⁶ *Ibid.* A word of caution is to be sounded. In this case the court was asked to interpret the provisions of section 195 (1) of the Companies Act 46 of 1926 rather than the Companies Act of 1973. This notwithstanding, it is submitted that the same test would be applicable in the granting of a final judicial management order in terms of section 432 and that the case is reflective of the correct approach.

3.4.5. JUST AND EQUITABLE

It must be 'just and equitable' for the order to be granted.⁷⁷ The phrase is not defined in the 1973 Act. Further, no conditions are provided to illustrate instances where it can be said to have been satisfied. Notwithstanding the fact that an applicant may be able to prove both part (a) and (b) of the requirements in section 427, the court retains discretion to not grant the order where it is of the view that to do so would not be just and equitable.⁷⁸ It would seem that the dominant interpretation (and starting point) as to what is 'just and equitable' is the view that an order for judicial management is a special privilege to be granted in very special circumstances.⁷⁹

It has been argued that the content of the words 'just and equitable' includes an analysis on the part of the court as to what would be in the best interests of the company's shareholders and creditors.⁸⁰ The size and economic impact of the company seeking a judicial management order would constitute relevant factors in determining whether it would be just and equitable to grant the order.⁸¹ Even though the size of an entity is a relevant consideration in the enquiry, it is neither determinate nor definitive

In judgments following upon *Tobacco Auctioneers* the approach followed seems expansive in orientation, where the 'best interests' of not only the company's creditors but those of the company and applicants in a matter were taken into account in the determining what the court considered to be just and equitable.⁸² It is submitted further that this is a significant difference to previous constructions adopted by courts in earlier cases in relation to this requirement.⁸³

⁷⁷ Section 427(1). It would seem that the courts have not provided a closed list of factors which would constitute 'just and equitable' circumstances, having often relied on a variety of factors in determining whether such circumstances exist or not. See *Guttman and others v Sunlands Township (Pty) Ltd supra* cf *Tobacco Auctions Ltd v Aw Hamilton (Pvt) Ltd* 1966 (2) SA 451 (R) at 453B.

⁷⁸ *Burdette* (Part 1) at 248; *De Jager v Karoo Koeldranke & Roomys (Edms) Bpk* 1956 (3) 594 (C) at 602.

⁷⁹ See *Silverman v Doornhoek Mines Ltd supra* at 353; *Weinberg and Another v Modern Motors (Cape Town) supra*; *Tobacco Auctioneers Ltd v AW Hamilton (Pvt) Ltd supra* at 453.

⁸⁰ *Olver* (1980) at 33; *Repp v Ondundu Goldfields Ltd* 1937 CPD 375 at 378; *Le Roux Hotel Management supra* at para 47. This seems to have been the approach followed by the court in *De Jager v Karoo Koeldranke & Roomys (Edms) Bpk supra*; *Marsh v Plows (SA) Ltd* 1949 (1) PH E4 (C). See further Loubser (2010), who describes this requirement in section 427 as 'most problematic!'

⁸¹ *Silverman v Doornhoek Mines Ltd supra* at 353; *Tobacco Auctioneers Ltd supra* at 453.

⁸² *Le Roux Hotel Management supra* at para 47.

⁸³ See *Silverman v Doornhoek Mines Ltd supra*; *Smith v Doornhoek Mines Ltd* 1935 TPD 349; *Ladybrand Hotel (Pty) Ltd v Segal and Another supra* at 359; *Kotze v Tulryk Bpk en n Ander supra* at 122; *Rustomjee v Rustomjee (Pty) Ltd* 1960 (2) SA 753 (D) at 758; *Ronaasen and Others v Ronaasen & Morgan (Pty) Ltd* 1935 CPD 562 at 563.

3.4.6. AN ALTERNATIVE TO WINDING-UP

The 1973 Act allowed for a winding-up order to be converted into an order for judicial management where the requirements of section 427(3) were satisfied. It would have to be shown that the conversion of winding-up proceedings to judicial management would result in the company becoming a successful concern and that the granting of the order would be just and equitable. Despite this, proceedings could not be initiated only on the basis that judicial management would result in a more advantageous dividend for creditors than in liquidation proceedings.⁸⁴

3.5. AMBIT OF JUDICIAL MANAGEMENT

Only companies could have recourse to the procedure.⁸⁵ Persons entitled to apply for judicial management included the company itself and any of its creditors or members.⁸⁶ The definition excluded partnerships, close corporations and Trusts. Loubser argues that due to the substantially higher investor funds and creditor claims often involved, judicial management was more geared towards large companies and was often too costly and inappropriate for small businesses.⁸⁷ She further observes that in the case of close corporations, section 72 of the Close Corporations Act of 1984 caters for the rescue of this enterprise through a compromise procedure which is capable of resulting in a winding up order being set aside.⁸⁸

3.6. JUDICIAL MANAGEMENT PROCEEDINGS

Where an application was made to initiate judicial management, an applicant was required to first lodge a copy of the application (with supporting affidavits) with the Master of the High Court in which the judicial management application would be

⁸⁴ See *Millman v Swartland Huis Meubileerders (Edms) Bpk* 1972 (1) SA 741 (C). The ability of the regime to enable a wind up which would be more advantageous for creditors at a later stage was seen as inconsequential. See further *Marais v Leighwood Hospitals (Pty) Ltd* 1950 (3) SA 567 (C).

⁸⁵ Section 427(1) makes reference to the word 'any company'. Section 1 of the 1973 Act describes 'company' to mean 'a company incorporated under Chapter IV of this Act and includes anybody which immediately prior to the commencement of this Act was a company in terms of any law repealed by this Act': *Ex parte Wellcut Garment Manufacturing Co (Pty) Ltd* 1953 (1) SA 629 (C).

⁸⁶ Section 427(2) read with section 346.

⁸⁷ Loubser (2004) at 142. However compare the approach of the court in the *Tobacco Auctioneers case* discussed *supra* which, with respect, is reflective of the economically sensible position. The legal structure adopted by a business is not necessarily indicative of its economic weight or influence. Members may choose to incorporate through a Close Corporation due to the real or perceived benefits of adopting this structure rather than, for example, a private company which may be associated with more stringent regulatory requirements.

⁸⁸ Loubser (2004) at 142, footnote 34.

heard.⁸⁹ An application could be brought by any person(s) entitled to apply for the company to be wound up.⁹⁰ After lodgement with the Master, the application would be filed at court.

In the initial application, it was not necessary for the applicant to inform creditors of the impending application for judicial management.⁹¹ However, section 197B(1)⁹² requires an employer finding itself in financial difficulties which may result in a sequestration or winding-up to advise its employees of such circumstances. Even though this section⁹³ does not make specific reference to judicial management, Loubser argues that due to its wide ambit, it would find application where an employer company contemplates making application for a judicial management order.⁹⁴ She further observes, correctly, that this is reflective of a drafting inconsistency between the judicial management regime in the 1973 Companies Act and certain provisions of labour legislation.⁹⁵ It was only at the stage where the final judicial management order was sought were the company's creditors required to be informed of the application.⁹⁶ This aspect is important in the light of the hypothesis raised by the thesis and is expanded upon later in the chapter.

3.6.1. THE PROVISIONAL ORDER

Having heard the application, the court was entitled to grant a provisional order for judicial management and state the return day, dismiss the application or make any other order it considered appropriate.⁹⁷ Custody and control of the company vested in the Master, who would transfer it to the provisional judicial manager and ultimately,

⁸⁹ Section 427(2) read with section 346(4). The court with jurisdiction to consider the application would be sitting where the company has its registered office or where its main place of business is situated.

⁹⁰ Companies Act of 1973, section 427(2). This includes the company, contingent or prospective creditors, its members or all these persons jointly.

⁹¹ Companies Act of 1973, section 427(2).

⁹² Labour Relations Act 66 of 1995.

⁹³ Labour Relations Act 66 of 1995, section 197B(1).

⁹⁴ Loubser (2004) at 152.

⁹⁵ Loubser (2004) at 152.

⁹⁶ Companies Act of 1973, sections 431 & 432.

⁹⁷ The return day must not exceed a period of 30 days from the granting of the provisional order for judicial management. See sections 432(1) and 428(1). Section 428(1) makes use of the term 'deems just'. There seems to be consensus between commentators that this would not include an order for winding up *mero motu*. A specific application for the company to be wound up would have to be made. In the absence of such application, the court would merely discharge the provisional order. See *Henocheberg on the 1973 Act* at 941; *Blackman et al Companies Act* at 15-19.

the final judicial manager.⁹⁸

A meeting must be convened by the Master of the High Court or a magistrate.⁹⁹ The purpose of the meeting is to conduct a discussion into the following: A consideration of the report by the provisional judicial manager as well as his/her view regarding (i) the prospects of the company becoming a successful concern as well as whether (ii) it is desirable to place the company under judicial management¹⁰⁰ (iii), the nomination of person(s) whose name(s) would be submitted to the Master for appointment as final judicial manager(s)¹⁰¹ and (iv) proving creditor claims. Creditors would, in addition, have had to consider whether to enter into a resolution providing preference for post-commencement liabilities over pre-judicial management unsecured liabilities in terms of section 435(1).¹⁰²

Once appointed, the duties of the provisional judicial manager would include: (i) assuming control of the assets of the company as well as its management (ii) preparing a report on the state of the company, its assets, liabilities and details of creditor claims (iii) providing reasons for the company's financial problems as well as how he/she intends to raise capital necessary to return the company to solvency and (iv) expressing an opinion as to the prospects of the company becoming a successful concern as well as how the judicial manager intends to remove barriers currently preventing this from happening.¹⁰³

3.6.2. THE FINAL ORDER

On the return date the court was required to consider the wishes of creditors, the report of the provisional judicial manager as well as the number of creditor claims that had not been proven at the first meeting of creditors (including the value of such claims).¹⁰⁴ Where the court was of the view that the granting of the final order would enable the company to become a successful concern and that it was in fact just and

⁹⁸ Companies Act 1973, sections 429 & 433. The reason for the vesting on the part of the Master has been explained on the basis of preventing the prospect of company property being dissipated during the periods between the granting of the order and the appointment of the provisional judicial manager. See Loubser (2004) at 153.

⁹⁹ Companies Act of 1973, section 429(b)(ii).

¹⁰⁰ Companies Act of 1973, section 431(2)(a) read with section 430(c).

¹⁰¹ Companies Act of 1973, section 431(2)(b).

¹⁰² Companies Act of 1973. It was a further requirement that the proceedings, conclusions drawn in the meeting as well as the reasons for conclusions drawn be recorded by the Chairman and presented to court.

¹⁰³ Companies Act of 1973, section 430 (a)-(c).

¹⁰⁴ Companies Act of 1973, section 432.

equitable to do so, it would grant the order.¹⁰⁵ Factors which were considered included the scarcity of information presented, the merits of the application as gathered from the papers and the affidavits produced by both the Master and provisional judicial manager.¹⁰⁶ The powers of the final judicial manager would be subject to the company's memorandum of association, to the extent that this was not inconsistent with an order made by court.¹⁰⁷

3.7. THE CONSEQUENCES OF JUDICIAL MANAGEMENT

3.7.1. MORATORIUM ON LEGAL PROCEEDINGS

A moratorium can be described as the suspension of all claims against the company subject to judicial management proceedings. It does not serve to discharge the company from the payment of its debts but rather provides it with much needed breathing space during judicial management.¹⁰⁸ The Act makes allowance for the operation of a moratorium once the provisional judicial management order has been granted.¹⁰⁹

The extent to which a moratorium was implied upon the granting of a final judicial management order has been the subject of much debate. Olver argues that it was generally accepted by authorities that judicial management implied a moratorium on proceedings; it was, however, still necessary for a specific order to be made.¹¹⁰

Loubser seems to agree with this view, arguing that the 1973 Act did not provide for an automatic moratorium and that applications for judicial management would have to contain this specific prayer on the papers.¹¹¹

Olver further observes that where no moratorium had been granted, the judicial manager could raise section 434 as a defence against a pre-judicial management creditor wishing to enforce its claim.¹¹² The section provides that any monies raised during the judicial management process are allocated to the costs associated with initiating judicial management and subsequently to the costs associated with the running of the business. Any excess monies would then be paid to

¹⁰⁵ Ibid.

¹⁰⁶ *Ladybrand Hotel (Pty) Ltd v Segal and another supra*.

¹⁰⁷ Companies Act of 1973, section 433.

¹⁰⁸ Loubser (2010) at 32.

¹⁰⁹ Companies Act of 1973, section 428(2)(c).

¹¹⁰ Olver (1980) at page 66.

¹¹¹ Loubser (2004) at 153. In her later work, Loubser (2010) at 32 observes that it is unclear whether a court could order a moratorium on some actions or whether the court was required to order a moratorium on all actions and further argues that the moratorium would most likely include a stay on criminal actions as well. Compare with section 133 of the new Act (71 of 2008) discussed in Chapter 4. For further reading, see Cilliers *et al* (2000) at 483.

¹¹² Companies Act of 1973. Olver (1980) at 67.

the claims of pre-judicial management creditors. This aspect will receive further consideration when the 1973 Act's treatment of creditors is discussed.

3.7.2. EFFECT ON CONTRACTS

The judicial manager could apply to court to set aside any undue preferences made to creditors, provided that such preferences were made while the company was unable to pay its debts.¹¹³ The provision allowed for a reversal of transactions which were financially prejudicial to the majority of the company's creditors, even if made prior to the institution of judicial management proceedings.¹¹⁴ It has been argued that the judicial manager could not refuse counter performance in terms of an uncompleted contract, as the moratorium did not necessarily find application against a claim for specific performance.¹¹⁵

3.7.3. TREATMENT OF CREDITORS

In addition to the powers of creditors relating to initiating judicial management proceedings¹¹⁶, creditor interests were catered for in provisions relating to nomination of the judicial manager¹¹⁷, the application of assets after commencement and provisions relating to consent to preference.¹¹⁸ The judicial manager was not permitted to dispose of the company's assets otherwise than in the normal course of proceedings.¹¹⁹

Section 434 was first introduced by the Companies Act Amendment Act¹²⁰ in the form of section 197B, which provided for assets to be applied to the payment of

¹¹³ Companies Act of 1973, section 436.

¹¹⁴ Companies Act of 1973, section 436(1). See further sections 26-34 of the Insolvency Act 24 of 1936 relating to dispositions without value, voidable and undue preferences to creditors, collusive dealings before sequestration, setting aside of improper dispositions and the voidable sale of business. This is to be compared to seemingly similar-but-practically toothless provisions in the 2008 Act relating to the powers of the business rescue practitioner. They, with greatest respect, do not go far enough in vesting the practitioner with tangible powers to retrieve monies where prejudicial or suspicious transactions have been entered into by the company prior to commencement of business rescue proceedings. Even though relevant for the purposes of broad discussion, practitioner powers are not given comprehensive discussion in the thesis.

¹¹⁵ Bertelsman *et al Mars The Law of Insolvency in South Africa* 9 ed (2008) Claremont: Juta & Co. Ltd at 222-225. It is to be noted that the observations made therein apply within the context of insolvency and sequestration of an estate as opposed to judicial management proceedings.

¹¹⁶ Companies Act of 1973, section 427(2).

¹¹⁷ Companies Act of 1973, sections 429, 431(2)(b) & (4).

¹¹⁸ Companies Act of 1973, sections 434 & 435.

¹¹⁹ Companies Act of 1973, section 434(1). The courts have differed on this aspect. In *Ex parte vermaak* 1964 3 SA 175 (O) leave was granted to the judicial manager to sell all the assets of the company as a going concern whereas in *Ex parte Paterson: In re Good Earth Estates (Pty) Ltd* 1974 4 SA 281 (E) this was refused. What is clear from both cases is that the courts have discretion to permit or deny such transactions.

¹²⁰ Companies Act Amendment Act 11 of 1932.

the costs, charges and expenses incurred in relation to judicial management and thereafter, the claims of creditors in a manner similar to that of insolvency law.¹²¹ The section was later replaced by a new section 197B.¹²² Sub-section 1 of the amended section 197B directed the judicial manager to apply monies, which became available to pay the costs of judicial management as well as satisfy the claims of creditors.

A proviso, in the form of sub-section (1) (a)¹²³ provided that where the manager continued the business in terms of the judicial management order, monies were to be used in the conduct of the business. The 1939 Act provided for pre-judicial management creditors to be able to consent to preference.¹²⁴ The section further mandated that costs of judicial management as well as the claims of creditors were to be paid in a manner similar to that of Insolvency law.¹²⁵

The recommendations of the Millin Commission introduced reforms to this section and occasioned a shift in emphasis.¹²⁶ In relation to the then new section 197B introduced by the 1939 amendment Act, the Commission expressed criticism as follows:

...This new section 197B, it should be noted, was not recommended by the Commission of 1935-36. In our opinion it is very far from being an improvement on the previous state of the law. By putting the emphasis on the use of the company's funds for the payment out of the claims of creditors and making the carrying on of the company's business a secondary matter, sight was lost of the whole purpose of judicial management, which is the conservation and the management of the assets of the company in such a way as to enable it eventually to be restored to the shareholders as a going concern. The new section 197B, we find, has acted as a direct encouragement to judicial managers to make no serious attempt to carry on the company's business but to proceed at once to liquidate its assets for the purpose of paying creditors such a dividend as may be available. Thus judicial management where it is allowed to take its course, is established as a process of winding-up without any kind of control by creditors or opportunity for investigating the affairs of the company...¹²⁷

In order to prevent an appointed judicial manager from liquidating the company once proceedings had begun, the commission recommended that a sale of company assets outside the ordinary course of business only be permitted where leave of court is granted.¹²⁸ The Commission further proposed an amendment to section 197B to the effect that any monies becoming available during judicial management be applied first to costs involved in conducting the company's business and then, in so

¹²¹ Companies Act Amendment Act 11 of 1932.

¹²² Introduced by the Companies Amendment Act 23 of 1939.

¹²³ Of section 197B, Companies Amendment Act 23 of 1939.

¹²⁴ Companies Amendment Act 23 of 1939, section 197B(1)(b). See further Olver (1980) at 127.

¹²⁵ Companies Amendment Act 23 of 1939, section 197B(2).

¹²⁶ Millin Commission Report (UG 69 of 1948) at 7.

¹²⁷ Millin Commission Report (UG 69 of 1948) at 94.

¹²⁸ Millin Commission Report (UG 69 of 1948) at 95.

far as circumstances allow, the payment of creditors.¹²⁹ The treatment of creditor claims as well the different interpretations adopted in defining its ambit and limitation is discussed next.

3.7.3.1. PRE AND POST JUDICIAL MANAGEMENT CREDITORS

The 1973 Act does not provide a definition for the word ‘creditor’. The Concise Oxford dictionary defines ‘creditor’ as ‘a person or company to whom money is owed’.¹³⁰ Shrand¹³¹ argues that section 435(1)(a) created two categories of concurrent creditors, consisting of those whose claims arose before judicial management and post-commencement concurrent creditors.¹³² As briefly observed earlier, pre-judicial management concurrent creditors ranked ahead of post-commencement concurrent creditors in terms of the payment of their claims.¹³³

The preference is exclusive of the costs of judicial management, which have a high priority.¹³⁴ Post-judicial management concurrent creditors would, however, rank equally among themselves and in the order in which the company incurred liability in relation to them.¹³⁵ If the company was subsequently to be wound up, this preference would continue to remain in force subject to the provisions relating to the proof of creditor claims in terms of the law of insolvency.¹³⁶ Post-commencement concurrent creditors could not demand preference in the absence of the resolution stated above.¹³⁷

¹²⁹ Subsequent to the Millin Commission proposals, the Companies Amendment Act 46 of 1952 was enacted into law. See Harry Rajak & Johan Henning (1999) at 265-6.

¹³⁰ Oxford University Press *South African Concise Oxford Dictionary* (2009) at 271. It is to be noted that no specific definition for the word is provided for in the Companies Act of 2008. The closest definition is that provided for in the word ‘independent creditor’.

¹³¹ Shrand (1977) at 336.

¹³² Shrand (1977) at 336.

¹³³ Section 434(2). Unless if pre-judicial management creditors accorded preference to post-judicial management creditors in a meeting, through the adoption of a resolution in terms of section 435(1) read with 429(b)(ii). See generally *Klopper en 'n ander NNO v Die Meeste en andere NNO* 1977 (2) SA 477 (T).

¹³⁴ Companies Act of 1973, section 435.

¹³⁵ Companies Act of 1973, section 435 (1)(a) & (b) read with s 429 and s 431(2)(d).

¹³⁶ Companies Act of 1973, section 435(1)(b)(i) read with section 366.

¹³⁷ See *Klopper en n ander NNO v Die Meest en andere NNO supra*. Here the court dealt with section 197(B)(1) which is identical to section 435 of the 1973 Act. Providing a restrictive interpretation, the court found that the expression ‘costs incurred by the judicial manager’ were to be regarded similarly to ‘costs of administration in the winding-up’ meaning management costs and specifically exclusive of expenditure incurred in conducting the company’s business. I submit that this approach is unduly restrictive. In *Norman Kennedy v Norman Kennedy Ltd* 1947 (1) SA 790 (C) a wider interpretation was adopted. However, the approach in *Norman Kennedy* was overruled by the Appellate division in *Wire Industries Steel Products and Engineering Co (Coastal) Ltd v Surtees NO and Heath NO* 1953 (2) SA 531 (AD).

The rights of secured creditors remained unaffected by this classification of preference in liquidation.¹³⁸

This approach may be contrasted with the provisions of the Companies Act 71 of 2008, where a preference is created by operation of law for certain categories of post-business rescue commencement claims in terms of section 135.¹³⁹ The question to be posed therefore is how, if at all, were the interests of employees balanced as against the interests of other unsecured creditors during judicial management proceedings in terms of the 1973 Act? This question is essential to understanding variations in the manner in which South African legislation has dealt with the often unclear and contentious issue of balancing creditor rights in the Act.¹⁴⁰ A discussion of this aspect follows.

3.7.3.2. EMPLOYEES AND ‘OTHER CREDITORS’

The 1973 Companies Act’s omission of any reference to the specific treatment of employees in respect of remuneration and similar payments prior to and during judicial management was a peculiar feature of the Act. Section 434(2) and (3) provides possible insight into the manner in which the 1973 Act (in its own provisions) sought to deal with the competing interests raised in this thesis¹⁴¹:

- (2) Any monies of the company becoming available to the judicial manager shall be applied by him in paying the costs of the judicial management and in the conduct of the company’s business in accordance with the judicial management order and so far as the circumstances permit in the payment of claims of creditors which arose before the date of the order.
- (3) The costs of the judicial management and the claims of creditors of the company shall be paid *mutatis mutandis* in accordance with the law relating to insolvency as if those costs were costs of the sequestration of an estate and those claims were claims against an insolvent estate.

Meskin *et al*¹⁴² amplify the distinction drawn by the Act between the ‘costs of judicial management’ and those relating to ‘the conduct of the company’s business’.

They articulate the latter in the following manner:

...By the [conduct of the company’s business], it is submitted, is meant that the total expenditure which the continuation of the company’s operation entails (e.g. in respect of employees’ wages, charges for the supply of essential services such as water or electricity...) including the amounts of

¹³⁸ Shrand (1977) at 336. See further *Henocheberg on the Companies Act of 1973* at 950.

¹³⁹ This aspect is discussed in Chapter 4 of the thesis in greater detail.

¹⁴⁰ Companies Act 71 of 2008.

¹⁴¹ See broad discussion of this section and various amendments which culminated in it in the earlier part of the chapter. Michael Blackman ‘The Employee and the Insolvent Company’ (1993) 14 *Industrial Law Journal* at 560. As will be seen from the discussion of the 2008 Act in later chapters, the ambit and degree of employee participation has been significantly enhanced. Chapter 6 of the 2008 Companies Act ensures that employees are vested with a barrage of rights from the beginning of the process right up to its end both as employee creditors specifically as well as forming part of a broader group of the company’s creditors.

¹⁴² Meskin *et al* *Henocheberg on the Companies Act of 1973*.

all post-judicial management liabilities. It is submitted that the intention is that during the final judicial management, in addition to the costs of judicial management, all such expenditure must be discharged, i.e. in so far as it comprises the amounts of post-judicial management liabilities, even if no resolution as envisaged by s 435(1)(a) has been adopted, before any pre-judicial management debt is paid...¹⁴³

In line with this view, employee wage and salary payments relating to both pre- and post-commencement of judicial management could in theory form part of the costs relating to the conduct of the company's business rather than purely as a stand-alone creditor claim during proceedings and in this way be eligible for preference.¹⁴⁴

Meskin *et al* further observe that judicial management did not create a *concursum creditorum*¹⁴⁵ and therefore the discharge of a pre-judicial management liability could in this way be seen 'as an incident of the continued operation in the final management of a pre-judicial management contract....'¹⁴⁶ Blackman seems to agree with this approach.¹⁴⁷ In this light, it is highly doubtful whether the ranking and preference referred to by Shrand above in relation to pre-judicial management creditor claims in terms of the 1973 Act would have had any practical effect.

Discussing the words '*mutatis mutandis*' in section 197B(2)¹⁴⁸ which was identical to section 434(3)¹⁴⁹, the court in the *Union Goldfields case*¹⁵⁰ said:

...under the provisions of sec. 197(B) (2) the law relating to insolvency must be applied with only such changes as the difference between the provisions of the Companies Act in relation to judicial management and the Insolvency Act in respect of sequestration render necessary.¹⁵¹

It is apparent that the judicial management provisions of the 1973 Act did not attempt to systematically resolve competing interests between employees and other concurrent creditors. It would seem that employee salary claims (both pre and post judicial management) could in theory either be incorporated as part of the 'cost' of the process, as highlighted above¹⁵² or more likely as a cost incurred in conducting the company's business. Alternatively, such claims could be dealt with in a manner

¹⁴³ At page 950. Compare with approaches adopted in the *Klopper en 'n ander NNO and Wire Industries Steel cases supra*.

¹⁴⁴ Such approach would, it is submitted, pass the restrictive tests seen in the *Norman Kennedy and Wire Industries cases*.

¹⁴⁵ The *locus classicus* is the case of *Walker v Syfrets* 1911 AD 141 at 166.

¹⁴⁶ At page 950. See Further Rajak (1993) at 304.

¹⁴⁷ Blackman (1993) at 560.

¹⁴⁸ Companies Act 46 of 1926.

¹⁴⁹ Companies Act 61 of 1973.

¹⁵⁰ *Judicial Managers New Union Goldfields v New Witwatersrand Gold Co.* 1950 (4) SA 135 (W) subsequently confirmed by the Appellate Division under the same name, case no 1951 (1) SA 545 AD.

¹⁵¹ At page 110.

¹⁵² However the restrictive interpretation of this aspect by the Appellate Division in *Wire Industries* cannot be ignored.

aligned to ranking in terms of the Insolvency Act.¹⁵³

In laying a foundation for a discussion of the manner in which the new business rescue provisions in Chapter 6 attempt to deal with the often conflicting interests of creditors, a closer analysis of the manner in which insolvency law treats creditor claims is apposite. This is due to the fact that the 1973 Companies Act makes a number of references to insolvency law in the judicial management procedure. Even more important is to contrast this approach with the 2008 Act, the provisions of which have a significant impact on the ranking of claims not only within the context of Chapter 6 but on the ranking in terms of insolvency law.¹⁵⁴

3.8. COMPANIES ACT OF 1973 AND INSOLVENCY LAW: LINKAGES

The 1973 Act regulated the manner and purpose of the meeting of creditors convened by the Master.¹⁵⁵ It further prescribed the application of insolvency law in relation to the proof of creditor claims.¹⁵⁶ The winding up provisions of the 1973 Act provide that when a company, being wound up, is unable to pay its debts, the provisions of the Insolvency Act find application.¹⁵⁷ The procedure for proving a claim depends on whether the claim in question is liquidated or conditional. Where it is a liquidated claim, section 44¹⁵⁸ applies and section 48¹⁵⁹ finds application in respect of conditional claims. Where a creditor is unable to prove its claim in the meeting mentioned above, such creditor may request that the Master convene a further special meeting so that it can prove its claim.¹⁶⁰

¹⁵³ Insolvency Act 24 of 1936.

¹⁵⁴ This is explored in Chapter 4.

¹⁵⁵ In terms of section 429(b)(ii).

¹⁵⁶ Companies Act of 1973, section 431(4).

¹⁵⁷ See further section 366 of the Companies Act of 1973, where claims against the company being wound up are to be proven in terms of the law of Insolvency.

¹⁵⁸ Insolvency Act 24 of 1936.

¹⁵⁹ Insolvency Act 24 of 1936.

¹⁶⁰ Section 429 (b)(ii) of the Companies Act of 1973 read with section 42 of the Insolvency Act of 1936. Upon the granting of a final order of sequestration/liquidation the Master is required in terms of section 40(1) to publish a notice convening a first meeting of creditors for the proof of claims as well as the appointment of the trustee/liquidator among other matters. Once appointed, the trustee/liquidator must in addition convene a second meeting of creditors in terms of section 40(3)(a) for the purpose of allowing for the proving of further claims and the receipt of the trustee's report on the estate, among others. A further, special meeting may be convened where creditor claims have not been proven in the first and second creditor meetings in terms of section 42(1).

3.8.1. RANKING OF CREDITOR CLAIMS IN INSOLVENCY ACT

The Insolvency Act creates a ranking of creditor claims. Claims fall into one of three categories, namely secured, statutorily preferent and concurrent. The ranking may summarily be outlined as follows, in descending order: The first is liquidation costs.¹⁶¹ The second is the claim of secured creditors.¹⁶² The third is the claim of preferent creditors.¹⁶³ This claim is paid from the proceeds of unencumbered assets in a predetermined order.¹⁶⁴ Employee remuneration (capped at a certain amount and time period)¹⁶⁵ and the claim for outstanding taxes by the South African Revenue Services (SARS) are included in this category.¹⁶⁶ The fourth category is that of concurrent creditors. These creditors are paid from the sale of proceeds from unencumbered assets after preferent claims have been paid in full. Payment is made in proportion to the amounts owed to them. If an excess amount remains, it must satisfy the interest on concurrent claims from the date of liquidation to the date of payment.¹⁶⁷

Having broadly explored the manner in which insolvency law deals with claims of creditors, a closer analysis of the Insolvency Act's treatment of employee-creditor claims must be entered into. In discussing the ranking of employee-creditor claims in insolvency law, the purpose of the discussion is to provide an analysis of the treatment of employee creditors within insolvency law as well as possible insight into how this creditor could be dealt with in terms of the Insolvency and Companies Acts.¹⁶⁸

3.8.2. EMPLOYEE CREDITORS IN INSOLVENCY LAW: TRENDS AND DEVELOPMENTS

Developments in insolvency law (although couched within the context of sequestration and liquidation of an employer entity) provide an important outline of the increasing prominence that employees gained within the judicial management regime, even if indirectly. Employee claims are treated as statutorily preferent in

¹⁶¹ Insolvency Act of 1936, section 97 & 98.

¹⁶² Insolvency Act of 1936, sections 95(1).

¹⁶³ Insolvency Act of 1936, section 98A.

¹⁶⁴ See Bertelsmann *et al* (2008) at 476.

¹⁶⁵ This category is specifically discussed below.

¹⁶⁶ Insolvency Act of 1936, section 99.

¹⁶⁷ Insolvency Act of 1936, section 103.

¹⁶⁸ Act 24 of 1936 and Act 61 of 1973 respectively.

insolvency and their payability depends on the availability of funds in free residue.¹⁶⁹ The claims consist of salary, wages, employer contributions to pension and provident funds, medical aid, sick leave, outstanding holiday days not taken and employee scheme payments among others.¹⁷⁰

Van Eck *et al*¹⁷¹ observe that the effect of the replacing section 100 with 98A of the Insolvency Act¹⁷² was to elevate the preference of employee claims in relation to the claim of other preferent creditors such as the South African Revenue Service for outstanding taxes in a winding-up or sequestration.

The 1936 Insolvency Act grants employee creditors a claim for the payment of wages due, dating back to maximum of three months prior to insolvency with a current limitation of R 12 000 per employee.¹⁷³ It also provides a claim for accrued leave (holiday or paid leave of absence), which was payable in the year of insolvency or the previous year, whether or not such payment was due at the date of insolvency with a current limitation of R 4 000 per employee.¹⁷⁴ An employee need not prove the preferential portion of his/her claim even though a liquidator may request him/her to submit an affidavit as proof.¹⁷⁵ A concurrent portion which exceeds the statutory limits must be proven in the ordinary course.¹⁷⁶

As briefly observed, where an employer finds him/herself experiencing 'financial difficulties'¹⁷⁷ which have the potential of resulting in a winding-up, the employer is duty bound in terms of the Labour Relations Act¹⁷⁸ to advise a party representing employees of this fact.¹⁷⁹ The purpose of consultations is to try to avoid or minimise dismissals on operational requirements, establish an agreed upon method

¹⁶⁹ Stefan Van Eck, Andre Boraine and Lee Steyn 'Fair Labour Practices in South African Insolvency Law' (2004) 121 *SALJ* 902 at 917; Blackman (1993).

¹⁷⁰ Insolvency Act of 1934, section 98A.

¹⁷¹ Stefan Van Eck, Andre Boraine and Lee Steyn (2004) at 906.

¹⁷² Insolvency Act of 1936.

¹⁷³ Insolvency Act of 1936, section 98A(1)(a)(i).

¹⁷⁴ Insolvency Act of 1936, section 98A(1)(a)(ii).

¹⁷⁵ Insolvency Act of 1936, section 98A(3).

¹⁷⁶ These claims will be payable in terms of section 103(1)(a) of the Insolvency Act. See further Bertelsmann *et al* (2008) at 487.

¹⁷⁷ This term is not defined in the Labour Relations Act of 1995.

¹⁷⁸ Labour Relations Act 66 of 1995, section 197B(1).

¹⁷⁹ Such 'party' may include persons to be consulted in terms of a collective agreement, workplace forum, a registered union, formal employee representatives or employees themselves where applicable. See Meskin *et al* *Insolvency Law Service Issue* 40 June 2013 Lexis Nexis at 2-40(1). For a discussion of the Labour Relations Act provisions within the context of the transfer of a business in both solvent and insolvent circumstances (Transfer of an Undertaking as a Going Concern also known as 'TUPE'), see Stefan Van Eck and Andre Boraine 'A Plea for the Development of Coherent Labour and Insolvency Principles on a Regional Basis in the SADC Countries' in Paul J. Omar (ed.) (2008) *International Insolvency: Themes and Perspectives* United Kingdom: Ashgate Publishing Limited.

for effecting retrenchments as well as the amount of severance pay to be given to employees.¹⁸⁰ A reason provided for the insertion of this provision is that with the increase in sequestration and liquidation of personal estates, concern was expressed that employees were the least informed category of persons and often found out when they were met by locked premises at their place of work due to a liquidation order having been granted.¹⁸¹

The employee-creditor has an additional claim for severance or retrenchment pay due where employment is terminated in terms of section 38.¹⁸² These amounts will only be payable where there is a free residue after the payment of higher-ranking claims.¹⁸³ Claims for severance pay have preferent status¹⁸⁴ but are capped.¹⁸⁵ The maximum amounts for each claim are set by the by the Minister of Justice by notice in the Government Gazette.¹⁸⁶

Despite rights granted to employees in cases of proposed retrenchments, the winding-up of a company provides a liquidator with a distinct advantage.¹⁸⁷ Upon the granting of the winding-up order, all employee contracts are automatically suspended. These suspended contracts automatically terminate within 45 days after a final liquidator has been appointed. An employee is left with a residual right to prove a claim for any damages sustained as a result of the termination; such claim has concurrent status.¹⁸⁸ The liquidator may, however, contract for the rendering of

¹⁸⁰ Section 189(2)(a), (b) and (c) of the Insolvency Act of 1936. It is observed that these provisions continue to apply within the context of retrenchments contemplated as part of a business rescue plan in terms of the Companies Act of 2008. Section 189A of the Labour Relations Act further provides employees with the right to strike should there be no agreement reached as to how dismissals should and will be conducted.

¹⁸¹ *Memorandum on the Objects of the Insolvency Second Amendment Bill, 2002* at paragraph 1.1. Loubser also outlines this aspect in her article. See A. Loubser 'The Interaction Between Corporate Rescue and Labour Legislation: Lessons to be Drawn from the South African Experience' (2004) *International Insolvency Review* Vol 14 Issue 1: 57-69 at 61. She further notes that no reference was made to judicial management in section 197B(1), outlining the possibility of this either having been a legislative omission or oversight.

¹⁸² Insolvency Act of 1936. This includes employer contributions due and payable at time of liquidation- contributions including amounts payable to any pension, provident, medical aid, sick pay, holiday, unemployment, training scheme or fund or a similar fund.

¹⁸³ Insolvency Act, section 98A.

¹⁸⁴ Due to various amendments to the Insolvency Act of 1936, discussed below.

¹⁸⁵ Currently the claim is capped at R 12 000, see sections 38 (11) and 98A(1)(a)(iv) of the Insolvency Act read with section 41(2) of the Basic Conditions of Employment Act (75 of 1997); Meskin *et al supra* at 5-74(2E); see Roger G Evans 'Preferential Treatment of Employee Creditors in Insolvency Law' (2004) *SA Merc Law Journal* at 463.

¹⁸⁶ In terms of section 98A(2).

¹⁸⁷ See section 38(1) of the Insolvency Act of 1936. See further Boraine & Van Eck 'The New Insolvency and Labour Legislative Package: How successful was the Intergration?' (2003) 24 *Industrial Law Journal* 1840 at 1845.

¹⁸⁸ Insolvency Act of 1936, section 38(10).

services with employees for the purpose of continuing services to the company.¹⁸⁹

Boraine & Van Eck argue that this requirement is reflective of a change in approach in insolvency law to saving the whole or at least part of the business as a going concern and a step in the right direction.¹⁹⁰ Within the context of reforms in insolvency law, Van Eck *et al* observe that the Congress of South African Trade Unions (COSATU) expressed the view that despite reforms having had a positive influence on the rights of workers, they failed to go far enough in ‘radicalising’ insolvency law as well as ensuring that a preference stronger than that of secured creditors was created for workers.¹⁹¹

Responding to the view expressed by COSATU regarding a stronger preference for employee creditors, they express the following concerns:

It may be argued that the granting of a super-priority to employee claims, which would rank above the claims of secured creditors, would infringe or impair the property rights, protected by section 25 of the Constitution, of secured creditors. Another important concern is that super-priorities may affect credit availability by imposing higher risks for secured creditors and for potential lenders. Ironically, this has the potential to jeopardize prospects of investment in a business, and consequently, in certain instances, will undermine the feasibility of the rescue of an ailing business...¹⁹²

It can be said that the fear alluded to by Van Eck *et al* may have already materialised; not through further amendments to the 1936 Insolvency Act, as may have been expected, but through certain provisions of Chapter 6 of the new Companies Act. As will be seen in later chapters, it will be argued that the super preference created by the ranking of creditor claims is extended by those provisions to the law of insolvency, affecting the ranking of creditor claims and creating the super preference alluded to by Van Eck *et al* above for certain categories of creditors including employees.¹⁹³

¹⁸⁹ Section 38(9) of the Insolvency Act. Termination of contracts during the period of suspension is possible, provided that the liquidator consults with employee representatives or with the employee themselves. See further section 38(4) of the Insolvency Act.

¹⁹⁰ Boraine & Van Eck (2003) at 1849.

¹⁹¹ This was prior to the enactment of the Companies Act of 2008. At page 918, see further the Memorandum on the Objects of the Judicial Matters Amendment Bill available at www.gov.za/gazette/bills/1997/b95-97.pdf accessed 13 January 2015.

¹⁹² Van Eck *et al* (2004) at 918.

¹⁹³ See sections 5 and 135 of the Companies Act of 2008.

3.9. TERMINATION OF JUDICIAL MANAGEMENT

An application to cancel proceedings has to be made either by the judicial manager or by a person having an interest in the company.¹⁹⁴ There is no specific time period for termination of judicial management proceedings.¹⁹⁵ This omission presented a real financial risk to the already struggling company, where unscrupulous judicial managers could drag proceedings in order to raise higher fees.

If at any time during proceedings the judicial manager formed the opinion that continuing judicial management proceedings would not enable the company to become a successful concern, he/she was required to apply for the cancellation of judicial management and winding-up of the company.¹⁹⁶ Cilliers *et al*, expounding on the procedural requirements that the judicial manager had to satisfy in an application for cancellation of proceedings, argue that the manager would have to show the court that (a) he possessed the requisite *locus standi* to bring the application in terms of 433(1) of the 1973 Act, (b) had formed an opinion in good faith, that the judicial management order be cancelled in terms of section 440(1) on the basis that continued operation is undesirable and that (c) the cancellation include a winding-up order on the grounds prayed for and in terms of section 344.¹⁹⁷

Upon a further analysis of the provisions, it appears that even though a person having an interest is entitled to apply for the cancellation of proceedings, only the judicial manager could specifically apply for the winding-up of the company.¹⁹⁸ Judicial management could continue indefinitely. In this way, the only control that the Act had over the judicial manager was that it compelled him/her to apply for cessation if continued proceedings were incapable of enabling the company to become a successful concern.¹⁹⁹ Commentators seem to be in agreement that section 440(1), which could be relied upon for cancellation of proceedings, did not prescribe that a

¹⁹⁴ Companies Act of 1973, section 440.

¹⁹⁵ See *Keens Electrical (Jhb)(Edms)(Bpk) v Lightman Wholesaler (Edms)Bpk* 1979 (4) SA 186 (T) at 189 where the court, even though vesting upon itself the discretion to incorporate a fixed period for proceedings, held that it would however be undesirable to do so. In the *Marsh v Plows (SA) Limited supra*, *Marais v Leighwood Hospitals (Pty) Ltd* 1950 (3) SA 567 (C) and *Irvin & Johnson cases* the courts, although not specifically delimiting time frames within which judicial management proceedings ought to conclude, emphasised the concept of reasonable time as an important indicator for cessation of proceedings.

¹⁹⁶ Companies Act of 1973, section 433(1).

¹⁹⁷ Cilliers *et al* (2000) at 491; See further *Ex parte Muller NO: In re PL Myburg (Edms) Bpk* 1979 (2) SA 339 (N) at 340. The court would order cancellation of proceedings in terms of section 440(1) of the 1973 Act. Regarding the jurisdiction of the court to order cancellation see *Ex parte Kelroe-Cooke* 1956 (2) SA 125 (N); *Ex parte Bloemfontein Board of Executors Ltd* (1938) 31 PH at E7.

¹⁹⁸ Companies Act of 1973 sections 433(1) and 440(1).

¹⁹⁹ Companies Act of 1973, section 443(1).

rule nisi first be granted before the granting of a final order of termination.²⁰⁰

3.10. CRITICISMS OF JUDICIAL MANAGEMENT

A summation of the short-comings of judicial management as well as the conservative approach adopted by the courts, was articulated in the luminous judgment of Josman J²⁰¹ where he held as follows:

For me, sitting as a judge to try to regenerate a system which has barely worked since its initiation in 1926, would not only be inappropriate, but would also require me to disregard the body of precedent that has been established incorporating a very conservative approach to judicial management.²⁰²

The court was acutely aware of the constraints it faced, in the form of established precedent, when it was requested to rectify and revive the system of judicial management by the applicants in that matter. Virtually admitting defeat, it ultimately deferred the evaluation of judicial management to the legislature. In the light of the judgment, which broadly spoke to the weaknesses of judicial management, a brief summation of specific criticisms raised against the regime follows.

Olver notes three reasons for the limited success of judicial management. He attributes the first to the traditional practice of appointing liquidators as judicial managers, notwithstanding that the duties inherent in these are diametrically opposed to each other.²⁰³ A historical reason for this practice was that judicial management, in terms of the 1926 Act, was traditionally associated with liquidation. This was further evidenced by its inclusion at the end of the chapter on winding-up in that Act.²⁰⁴

No regulatory control existed to monitor and set qualifications for judicial managers.²⁰⁵ The Act further did not make provision for the removal of delinquent or incompetent managers.²⁰⁶ This often presented an opportunity for abuse where a majority creditor, able to assert control over the judicial manager, could effectively control the process.²⁰⁷ Rajak and Henning agree with this view, arguing that a panel of retired or semi-retired businesspeople would have been more effective in ensuring the success of the process.²⁰⁸ Secondly directors of a struggling company were

²⁰⁰ Loubser 2010 at 42; Meskin *et al* at 958; Cilliers *et al* (2000) at para 26.43.

²⁰¹ *Le Roux Hotel Management (Pty) Ltd and another v E Rand (Pty) Ltd and another supra*.

²⁰² At para 60.

²⁰³ Olver (1986) at 86.

²⁰⁴ Olver (1986) at 86.

²⁰⁵ Loubser (2010) at 43.

²⁰⁶ Loubser (2010) at 43.

²⁰⁷ Loubser (2010) at 43.

²⁰⁸ Rajak and Henning (1999) at 282-5.

observed to be prone to applying for judicial management rather than to accept the prospect of liquidation.²⁰⁹ Thirdly where a provisional judicial manager was appointed, he/she would invariably assume the cap of liquidator.²¹⁰ Where investigations warranted a recommendation in favour of liquidation, the same judicial manager could apply to be the company's liquidator.²¹¹

Loubser argues that South Africa's creditor friendly insolvency system did not create fertile ground for judicial management to flourish.²¹² This was evident in instances where judicial management applications were often opposed by a creditor on the basis that the creditor believed that it was entitled to immediate payment of the outstanding debt.²¹³

The often trivial nature of applications for judicial management are cited as having been a contributor, where small privately owned companies would apply for the regime despite not having enough assets to cover the costs of the process.²¹⁴ Kloppers²¹⁵ disagrees with the view that judicial management was unsuited to small companies generally but rather attributes the failure of judicial management to the expensive court-supervised nature of proceedings.²¹⁶ He argues that the court-oriented nature of proceedings was one of the major drawbacks of the regime, where costs were often so high that funds, which were necessary for the success of the struggling company, ended up being spent on the process.²¹⁷

He observes that the requirement of insolvency on the part of the company acted as a bar to companies who wished to avail themselves for judicial management in order to avert insolvency.²¹⁸ Enabling the company to enter into judicial management at an earlier stage would have ensured that the salvaging exercise produced the desired results.²¹⁹

²⁰⁹ Olver (1986) at 86.

²¹⁰ Olver (1986) at 86.

²¹¹ With the liquidator's fees often being higher than those of the judicial manager. See Olver (1986) at 86.

²¹² Loubser (2007) at 157. Burdette refers to this as a 'liquidation culture' in Burdette 'Unified Insolvency Legislation in South Africa: Obstacles in the path of the unification process' (1999) 32 *De Jure* at 56. See Bertelsmann *et al* (2008) at 4.

²¹³ Loubser (2007) at 157. Anthony J Smits 'Corporate administration: A proposed model' (1999) 32 *De Jure* 80.

²¹⁴ Olver (1986) at 87.

²¹⁵ Kloppers (1999) at 417-434.

²¹⁶ Kloppers (1999) at 425. He suggests that the procedural aspect of judicial management should be subjected to scrutiny and reform; Rajak & Henning (1999) at 268 seem to agree with this view.

²¹⁷ Pieter Kloppers 'Judicial Management Reform Steps to Initiate a Business Rescue' (2001) 13 *SA Merc LJ* at 371.

²¹⁸ Kloppers (2001) at 371.

²¹⁹ Kloppers (2001) at 371.

The ability of the company to pay its debts was interpreted as implying the payment of such debts *in full*.²²⁰ This was viewed as both a major shortcoming of the regime and somewhat contradictory in the light of the provisions of the 1973 Act relating to compromise of debts.²²¹ The requirement that the company be capable of recovery to the point where it is capable of paying its debt in full is viewed by Rajak as one which is both unrealistic and outdated.²²²

The 1973 Act did not require a reasonably detailed plan of action regarding how the company was to be taken out of its position of insolvency.²²³ Even though the judicial manager was required to have some plan of future conduct in order to convince the court that judicial management was indeed the viable alternative, the plan of future conduct was neither officially sanctioned nor required by the regime and therefore had no specific status.²²⁴ The requirement of a *reasonable probability* of success of the company as a requirement for judicial management was perceived as being too burdensome on the company.²²⁵ It has been argued that the correct test should rather have been that of a *reasonable possibility*.²²⁶

The lack of an automatic moratorium on all actions and proceedings against the company created uncertainty as parties could not be fully certain that the court would impose a moratorium in addition to granting the order for judicial management.²²⁷

²²⁰ My emphasis. See *Ben-Tovim supra* at 332; *Porterstraat 69 Eiendomme (Pty) Ltd supra* at 616 and 620.

²²¹ Section 311. Loubser (2004) notes that sub-section 1 includes a judicial manager as being among the persons who may approach the court after having summoned a meeting of creditors for the purpose of compromising the company's debts.

²²² Rajak and Henning (1999) at 8. See further Rajak (1993) *Insolvency Law Theory and Practice* where the author at 307 lamented judicial management's failure to keep abreast of developments in comparative jurisdictions.

²²³ Kloppers (1999) at 427.

²²⁴ Kloppers (1999) at 427.

²²⁵ Kloppers (2001) at 375-77.

²²⁶ Kloppers (2001) at 375-77. Burdette (1999) at 58 shares the same view, arguing that the latter test, alternatively the test of 'reasonable prospect' be applied as the appropriate threshold for judicial management applications.

²²⁷ Loubser (2010) at 43.

3.11. CONCLUSION

The judicial management regime may be said to have been ahead of its time when it was introduced into the Companies Act of 1926. Bradstreet²²⁸ observes that as a result of this aspect, jurisdictions such as Australia looked to judicial management in developing their own rescue regimes.²²⁹ It may be argued that this may have been a contributor to its perceived failure as a mechanism (mixed with a combination of apprehension and distrust on the part of courts and creditors), where significant role players were in a position to contribute to its development or lack thereof.²³⁰

The courts have consistently emphasised the right *ex debito justitiae* of a creditor to have its debtor placed in liquidation.²³¹ For this reason, and many others, it may be accepted that the company law regime in terms of the 1973 Act had a strong creditor orientation, which leaned more in favour of liquidation than judicial management. Despite its creditor focus, there is nothing to suppose that the liquidation of a struggling company would, by default, have been more beneficial for the majority of creditors' interests. Liquidation, more often than not, serves those creditors who are either secured or statutorily preferent and who may not necessarily constitute a majority in number or value. In the light of this, it may be posited that a viable company has more to offer for its creditors than its immediate liquidation. It is this justification that had been echoed by the legislature from its inception in the Companies Act of 1926, which made judicial management a pioneering piece of rescue legislation.

Within the procedure, employees' claims could comprise various categories, with the Act having been sufficiently vague to allow the judicial manager to exercise his/her discretion regarding treatment, while amendments in insolvency law ensured that employee creditors received increasing prominence if a company ultimately was liquidated.

It may, however, be argued that the judicial manager was perhaps vested with too much discretion and that the rights of employees during judicial management were not as clearly articulated as they came to be in insolvency law. This factor may

²²⁸ Bradstreet (2011) at 353-4.

²²⁹ For further reading see Colin Anderson 'Viewing the proposed South African business rescue provisions from an Australian perspective' (2008) 11 *Potchefstroom Electronic Law Journal* 1 at 4.

²³⁰ A clear example being seen in the manner in which the regime received acceptance from the courts as illustrated by the jurisprudence.

²³¹ See generally *Bahnemann v Fritzmore Exploration case supra*; *Rosenbach & Co. v Singhs's Bazaar (Pty) Ltd* 1962 (4) SA 593 (D) at 597E-F; *ABSA Bank v Rhebokskloof (Pty) Ltd* 1993 (4) SA 436 (C) at 440f-441A.

provide a theoretical framework for understanding the extent of the involvement of trade unions in the drafting of the new Companies Act as well as in understanding the manner in which creditor interests came to be balanced in the business rescue provisions of the same Act.

It cannot be denied that there were many weaknesses in the system judicial management. Judicial reluctance further had a compounding as well as a stifling effect on the natural development of the regime. One may argue that even though it was pioneering in its purpose and objective, in practice it proved to be a regime whose growth was perpetually stunted.

Because of the maturity of both the judicial management and insolvency regimes, developments and amendments to these Acts have been time tested and thus have resulted in a logical progression, giving content to creditor interests (and employee creditor interests in particular). This aspect ought not have been lightly glossed over or placed at the altar of political expediency, in a consideration of a rescue regime that would replace judicial management.

It is, however, not suggested that insolvency law is best placed to ensure the protection of employee interests during insolvency or a rescue (where applicable). Neither is it suggested that creditor rights and interests were incontrovertibly articulated in the provisions of the 1973 Act. The question that must be asked is: Can it not be said that judicial management, notwithstanding its weaknesses, sought a balance of creditor interests which, arguably, may be seen as potentially lacking in Chapter 6 of the new Companies Act? Before a response can be offered, it is necessary to examine the new Act. The next chapter provides a narrative of the beginnings, founding principles and influences behind the new Companies Act of 2008, as well as a discussion of the provisions of the new business rescue regime.

CHAPTER 4: BUSINESS RESCUE PROVISIONS OF ACT 71 OF 2008

4.1. INTRODUCTION

As highlighted in introductory chapters, the new Companies Act has created a mechanism to ensure that companies undergoing temporary financial hardship should not have to succumb to liquidation where a temporary reprieve would have ensured a return to solvency.¹ In this way, the new approach has evidenced a shift away from creditor supremacy seen in the previous regime towards a greater emphasis on the restoration of liquidity.² It is this ethos that underpins the business rescue provisions of Chapter 6 of the new Act³ which incorporate flexible mechanisms for accessing the procedure, providing a much needed reprieve to the company from its creditors.

The chapter engages in an analysis of business rescue provisions of Companies Act and in doing so, discusses the following: Relevant definitions for the purpose of Chapter 6, indicating circumstances under which the procedure may be initiated, consequences flowing from the proceedings with particular focus on management-control and the operation of a moratorium. The manner in which the Act regulates the provision of financing, ranking of creditor claims and the treatment of employees as a specific class is explored. The chapter concludes with a discussion of the Act's treatment of creditor dissent as well as how this has been interpreted by the courts. Throughout the discussion, weaknesses observed in relation to the relevant provisions of Chapter 6 are highlighted.⁴

4.2. DEFINITIONS

4.2.1. BUSINESS RESCUE

The definition of business rescue communicates the moment at which proceedings may be initiated, what the process should aim to achieve as well as the consequence ensuing upon commencement. 'Business rescue'⁵ is defined as:

- Proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for –
- (i) the temporary supervision of the company, and of the management of its affairs, business and property;

¹ See discussion in Chapter 1. See further the provisions of section 7 of the 2008 Act.

² It may be argued that the creditor supremacy continues to underpin our rescue regime, when the provisions of section 128 relating to the definition of 'business rescue' are considered. However, when the definition of business rescue and the practitioner's fiduciary duties are analysed, a higher premium is placed on the company's survival (i.e. the business or the legal entity or both) rather than only on payment of creditors' claims. This aspect is analysed later in the chapter.

³ Companies Act 71 of 2008.

⁴ The weaknesses highlighted are by no means exhaustive. It is hoped that as business rescue matures as a procedure, further research will develop in an attempt to resolve some of these.

⁵ Companies Act 71 of 2008, section 128(1)(b).

- (ii) a temporary moratorium on the rights of claimants against the company or in respect of the property in its possession; and
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company...⁶

It is a requirement that prior to accessing the procedure, the company be financially distressed.⁷ Once the condition of financial distress is satisfied, there follows three consequences: (i) a shift in control in favour of an appointed business rescue practitioner⁸, (ii) a temporary reprieve in the form of a moratorium⁹ and (iii) the development of a rescue plan.¹⁰ The purpose of the plan is to restructure the affairs of the debtor company with the aim of either returning the company to solvency or to derive a higher return for its creditors or shareholders than in liquidation.¹¹

It may not be possible for the company to be returned to a position where debts existing prior to business rescue debts are paid in full. The Act provides sufficient flexibility for a company to compromise its existing debt and in certain instances extrapolate those components capable of being salvaged¹² to the extent that such course is capable of resulting in a higher return for creditors or shareholders than in liquidation.¹³ In order to better understand the definition's context as well and its underlying purpose, it is apposite that the jurisprudence on this aspect receives discussion.

There is a burgeoning jurisprudence concerning business rescue. In *Redpath Mining South Africa (Pty) Ltd v Piers Marsden*¹⁴ the court had to deal with an urgent

⁶ The anatomy of the provision has received brief introductory discussion in Chapter 1.

⁷ Discussed below.

⁸ Existing management may be retained or removed during the process. This is at the discretion of the business rescue practitioner.

⁹ The moratorium may operate as an interim or final moratorium, depending on the manner in which proceedings are initiated.

¹⁰ For further literature on this aspect, see Pretorius, M. and Rosslyn-Smith 'Expectations of a business rescue plan: international directives for Chapter 6 implementation' (2014) 18 (2) *South African Business Review* 108.

¹¹ Farouk HI Cassim 'Business Rescue and Compromises' in *Contemporary Company Law* 2 ed (2012) Claremont: Juta Publishers at 861-912.

¹² For example through the sale of its business and goodwill to a third party, leaving the legal shell with its liabilities behind.

¹³ Section 128(1)(b)(iii).

¹⁴ *Redpath Mining South Africa (Pty) Ltd v Piers Marsden NO and others* (North Gauteng High Court) case no. 18486/2013 of 14 June 2014. Kgomo J made similar observations in the earlier case of *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and others* case no. 18486/2013 of 10 May 2013.

application seeking to set aside a business rescue plan which had been adopted by the respondents as well as an order granting the applicant permission to institute legal proceedings against first respondent in terms of section 133(1) (b). The court, held that:

Business rescue, as the definition proclaims or exclaims, is a regime which is largely self-administered by the company, under independent supervision within the constraints set out in Chapter 6 of the Act and subject to court intervention at any time on application by any of its stakeholders...Unlike judicial management, business rescue does not require that a company be restored to solvency, though this is of course one of the objectives of business rescue. As the definition (of business rescue) further demonstrates, business rescue is also a system that is aimed or geared at temporarily protecting a company against the claims of creditors so that its business can thereafter be disposed of (if the concern could not be saved) for maximum value as a going concern in order to give creditors and shareholders a better return than they would have received had the company been liquidated.¹⁵

Kgomo J further noted:

Business rescue clearly envisages a restructuring of a company's business, followed, if all else fail, by a realisation of its assets by, for example, a sale of its business to a third party followed by a voluntary winding-up of the company under section 80 of the Act, in accordance with the rules regulating voluntary winding-up of solvent companies.¹⁶

The public interest element of business rescue has also received judicial attention. In *Koen v Wedgewood*¹⁷ the following was observed:

...It is clear that the legislature has recognised that the liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods. It is obvious that it is in the public interest that the incidence of such adverse socio-economic consequences should be avoided where reasonably possible. Business rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations in cases in which there is a reasonable prospect of salvaging the business of the company in financial distress, or of securing a better return to creditors than would probably be achieved in an immediate liquidation.¹⁸

The purpose of business rescue has in other instances been couched in more cautious terms:

Section 7, in its turn, lists a wide range of purposes, including the promotion of compliance with the Bill of Rights as provided for in the Constitution. I respectfully agree that the Chapter as a whole reflects 'a legislative preference for proceedings aimed at the restoration of viable companies rather than their destruction' but *only of viable companies, not of all companies placed under business rescue*.¹⁹

¹⁵ *Redpath* at para 42-3.

¹⁶ *Redpath* at para 44.

¹⁷ *Koen and another v Wedgewood Golf and Country Estate (Pty) Ltd & others* 2012 (2) SA 378 (WCC).

¹⁸ *Koen supra* at para14-15; *Van Niekerk v Seriso* 321 CC Case no 952/11 and 23929/11 [2012] ZAWCHC 63 (20 March 2012) (WCC).

¹⁹ My emphasis. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* (3878/2013) [2013] ZAKZPHC 56; 2014 (1) SA 103 (KZP); [2014] 1 All SA 173 (KZP) (21 October 2013) at para 10; see *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd & another (Advantage Project Managers (Pty) Ltd Intervening)* 2011 (5) SA 600 (WCC) at 603 E-F.

Loubser argues that the business rescue definition implies the rescuing of *the company as a whole* as opposed to the rescue of its business or part thereof.²⁰ She further observes that this aspect makes it more akin to judicial management except in so far that the definition accommodates the achievement of an alternative purpose.²¹ Loubser's remark above is to be viewed in light of the *dictum* of the court in *Redpath Mining* where the court, per Kgomo J, made the following observation:

Unlike during judicial management, business rescue does not require that a company be restored to solvency, though this is of course one of the objectives of business rescue. As the definition (of business rescue) further demonstrates, business rescue is also a system that is aimed or geared at temporarily protecting a company against the claims of creditors so that its business can be thereafter be disposed of...for maximum value as a going concern in order to give creditors and shareholders a better return than they would have received had the company been liquidated.²²

This evidences a clear departure from the earlier judicial management regime to one which is sensitive to the societal impact of company failure.²³ This, it is submitted, in turn depicts an affirmation of the outcomes envisaged by the Companies Act in section 7.

4.2.2. FINANCIAL DISTRESS

The definition of business rescue is to be read with the definition of 'financial distress',²⁴ described as a situation where:

- (i) It appears to be reasonably unlikely that the company will be able to pay off all of its debts as they become due and payable within the immediately ensuing 6 months; or

²⁰ My emphasis. Loubser (2010) at 45.

²¹ That is, a better return for creditors than in liquidation. See section 128(1)(b)(ii)). Loubser (2010) at 45. This view seems to find support in Meskin *et al* in *Henochsberg on the Companies Act of 2008* at 448 who argue that the use of the word 'rehabilitation', despite not being specifically defined in the Companies Act, intimates the recovery of the company to complete solvency in a manner similar to the previous judicial management regime. The difference with the former regime, in their view, is that the new Act caters for an alternative purpose, i.e. the deriving of a higher return for creditors than would have been received in liquidation.

²² At para 43.

²³ The remarks of the court in *Griessel and Another v Lizemore and Others* (High Court of South Africa, Gauteng Local Division, Johannesburg) case no. 2015/24751 of 26 August 2015 (revised 28 August) are apposite where at para 80 the court remarked:

'If the second ground for business rescue [being a better return for shareholders or creditors than in liquidation] is not a qualified alternative to the first then the interests of employees will be ignored. The reason is that, if unqualified, the second ground is only concerned with determining whether creditors and shareholders will receive a better return under business rescue than on liquidation, leaving out of the equation the employees' interests in retaining jobs via rehabilitating the company. Such a result would be inimical to one of the fundamental paradigm shifts provided for in the new Act; the recognition of the rights and interests of employees alongside those historically accorded to shareholders, directors and creditors in matters affecting the affairs of a company both internally and externally. It could hardly have been the intention of the legislature to permit the interests of employees to be by-passed in cases where a dividend return under business rescue through say asset stripping would be better for only creditors or shareholders than liquidation without first considering whether the survival of the company as a going concern was feasible...'

²⁴ Section 128 (1)(f)(i)(ii).

- (ii) It appears to be reasonably likely that the company will become insolvent within the immediately ensuing 6 months;

It appears that a reasonable *prospect or probability*²⁵ of insolvency occurring within a six month period is sufficient for a company to have recourse to business rescue.²⁶ The test for financial distress provides a degree of flexibility for companies as many are often commercially rather than factually insolvent.²⁷ It has been argued that whether a company benefits from business rescue depends on whether the financial distress is due to internal or external factors.²⁸ An internal factor may consist of high salary costs and over employment while an external factor might present itself in the form of unanticipated economic changes having a negative impact on the business.²⁹

Articulating the content of ‘financial distress’, the court in *Redpath Mining* has held that:

Throughout the process of business rescue the expression “*financially distressed*” takes centre stage. This makes it crucial that we define or give forth how this concept of “*financially distressed*” is set out in the Act... From the above definition it is clear that a business rescue plan cannot be invoked where a company is already insolvent. This is one of the aspects differentiating business rescue from judicial management: Proceedings can be started six months in advance when the tell-tale signs are starting to appear. For instance, a company that is trading profitably and is cash positive but does not have the wherewithal to repay a large debt which will become due and payable within the next six months would qualify to be classified as being “*financially distressed*”, thus being a candidate for business rescue.³⁰

Redpath Mining provides a helpful distinction between commercial and factual insolvency.³¹ Once a company is factually insolvent, it may be too late for such company to be rescued.³² Legislation therefore requires pre-emptive action on the part of the company’s directors and affected persons.³³ Burdette³⁴, expressing concern at

²⁵ See *Van Dyk v Adroit Communications (Pty) Ltd and Another* (68048/2013) [2013] ZAGPPHC 376 (19 November 2013).

²⁶ Cassim (2012) at 864; *Gormley v West City Precinct Properties (Pty) Ltd (Anglo Irish Bank Corporation Ltd intervening; Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd* (Case 19075/11 and 15584/11) [2012] ZAWCHC 33 (18 April 2012)(WCC).

²⁷ Cassim (2012) at 864.

²⁸ Bradstreet (2011) at 357.

²⁹ Bradstreet (2011) at 357.

³⁰ *Redpath Mining supra* at paras 45-7. The same sentiments were echoed in the *Merchant West Working Capital case* at paras 7-8.

³¹ *Redpath Mining* at paras 45-7. On ‘commercial insolvency’ see *ABSA Bank v Rhebokskloof (Pty) Ltd supra* at 440 F-H.

³² *Redpath supra*. However see *Burmeister and Another v Spitskop Village Properties Ltd and Others case* (High Court of South Africa, Pretoria) unreported case no. 76408/ 2013 of 21 September 2015 at para 21 where the court held that the status of a company in final liquidation does not bar the enquiry into financial distress in terms of section 128(1)(f). It would be difficult not to find that a company against which an order for final liquidation had been granted, to not be factually insolvent. It may be argued that the *dictum* of the court serves to emphasise that an enquiry into a company’s financial distress is a factual one, notwithstanding such company’s legal status.

³³ In relation to the latter category, see section 131 of the new Companies Act.

the relatively late stage at which rescue proceedings could be initiated by an entity in terms of the previous judicial management regime, makes the following observations:

Considering that very few insolvent entities that have already reached the stage where they are so insolvent that they can be liquidated have been saved in the past, it is clear that South Africa should provide for a system of business rescue where the management of the debtor, for example, should seek help long before the entity itself can or should be liquidated (in other words before the entity is hopelessly insolvent).³⁵

Observing the above, the stage at which a company is able to have recourse to rescue proceedings may contribute to the success or failure of the intervention. It is submitted that the recommendations made by Burdette³⁶ are echoed in the current tests for financial distress in the Act.³⁷ The tests are in turn to be read with the Act's reckless trading provisions.³⁸

4.2.3. REASONABLE PROSPECT

The definition of 'business rescue' refers to a '*likelihood* of the company continuing on a solvent basis...'³⁹ This has been interpreted by some as evidencing a further similarity to the judicial management test of 'reasonable probability'.⁴⁰ Section 128 (1)(b)(iii) makes use of the word '*likelihood*' while sections 129(1)(b) and 131(4)(a) make use of the words '*reasonable prospect*'.⁴¹

The origins of 'likelihood' as a test may be traced back to section 457 of the

³⁴ Burdette (Part1) at 262.

³⁵ Burdette (Part 1) at 262.

³⁶ Burdette (Part 1) at 262.

³⁷ This view seems to accord with that expressed by Cassim (2012) above.

³⁸ Companies Act of 2008, section 22. Specific discussion of section 22 is unfortunately beyond the scope of this thesis.

³⁹ My emphasis. Companies Act of 2008, section 128(b)(ii).

⁴⁰ Loubser (2010) at 45 and 58. However, she later observes that the word 'reasonable prospect' must be taken to mean a 'reasonable possibility' as opposed to a 'probability'. The varying tests for judicial management proceedings, on initial application and return date, have received specific discussion in Chapter 3. For a detailed discussion of this aspect, the reader is referred to the discussion in that chapter.

⁴¹ In the earlier *Welman v Marcelle Props 193 CC and Another* (33958/2011) [2012] ZAGPJHC 32 (24 February 2012) matter, the court at para 28 held that business rescue is neither for the terminally nor chronically ill but rather for ailing corporations capable of recovery if given time. In *Finance Factors CC v Jayesem (Pty) Ltd* [2013] ZAKZDHC 45 (22 August 2013) the court at para 18 observed that the requirement of 'reasonable prospect' within the context of setting aside a resolution in terms of section 130(1)(a)(ii) was a mirror image of that contained in section 131(4)(a)(iii), which the court had to consider in making an order in favour of business rescue proceedings. See the *dictum* of the court in *Oakdene Square Properties (Pty) Ltd & others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 SA 539 (SCA) at para 18. See *Pouroullis v Market Pro Investments 106 (Pty) Ltd (South African Bank of Athens Ltd and Absa Bank Ltd* (20370/2015) [2016] ZAGPJHC 12 (12 February 2016) (Unreported) where the court affirmed the approach of the SCA in *Oakdene* that establishing a 'prima facie' case was simply not enough. See further the recent unreported judgment Sutherland J in *Paul de Robillard v Doltek Enterprises (Pty) Ltd (In Liquidation) and Others* (High Court of South Africa, Gauteng Division, Pretoria) case no. 36259/2016 of 14 September 2016 at paras 28-29.

Companies Act of 1973.⁴² The transplantation of this term into section 128 of the new Act appears superfluous and may result in unnecessary confusion. Both sections 129 and section 131 contain tests that govern the *manner* in which proceedings may be initiated.⁴³

It must be shown, in initiating proceedings by board resolution as well as by court order that ‘a reasonable prospect’ for rescuing the company exists.⁴⁴ A discussion of the ambit of ‘reasonable prospect’ as well as how this concept has been interpreted by the courts, is apposite. In *Southern Palace Investments*⁴⁵ the court made the following observations:

The meaning of the term “reasonable prospect” as used in this subsection falls to be considered. [Section 427(1)] of the previous Companies Act, no 61 of 1973, a rather cumbersome and ineffective procedure was provided for reviving ailing companies. That section of the 1973 Companies Act used the phrase “reasonable probability”...In contrast, section 131(4) of the New Act uses the phrase “reasonable prospect” in respect of the recovery requirement...The use of different language in this latter provision indicates that something less is required than that the recovery should be a reasonable probability. Moreover, the mind-set reflected in various cases dealing with judicial management applications in respect of the recovery requirement was that, *prima facie*, the creditor was entitled to a liquidation order, and that only in exceptional circumstances would a judicial management order be granted. The approach to business rescue in the new Act is the opposite- business rescue is preferred to liquidation.⁴⁶

Noting the thresholds that had to be satisfied by an applicant seeking to place an entity in business rescue, the court further stated:

One would expect, at least, to be given some concrete and objectively ascertainable details going beyond mere speculation in the case of a trading or prospective trading company, of:

- 24.1. the likely cost of rendering the company able to commence with its intended business, or to resume the conduct of its core business;
- 24.2 the likely availability of the necessary cash resource in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or are resumed. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;
- 24.3 the availability of any other necessary resource, such as raw materials and human capital;
- 24.4 the reasons why it is suggested that the proposed business plan will have a reasonable prospect of success.

In relation to the alternative aim referred to in section 128(b)(iii) of the new Act, being to procure a better return for the company’s creditors and shareholders than would result from the immediate liquidation thereof, one would expect an applicant for business rescue to provide concrete factual details of the source, nature and extent of the resources that are likely to be available to the

⁴² For a broader discussion, see Chapter 3.

⁴³ My emphasis. This aspect is to receive discussion at a later stage.

⁴⁴ Sections 129(1)(b) & 131(4)(a).

⁴⁵ *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Limited and others* (WCHC) unreported case no. 15155/2011 of 23 November 2011.

⁴⁶ At paras 20-21.

company, as well as the basis and terms on which such resources will be available...⁴⁷

Slightly differing approaches in relation to this threshold have been followed in subsequent judgments, with the courts often citing the *Southern Palace* judgment with approval but adopting a different set of thresholds or outlining the said thresholds in *obiter* remarks. In *DH Brothers* the court accepted the above approach as correct without deciding.⁴⁸ Citing the *dictum* of Eloff AJ in the *Southern Palace Investments case*⁴⁹ with approval, Binns-Ward J provided further content to ‘a reasonable prospect for rescuing the company’ as follows:

...the applicant would be required to set out in the founding papers a reasoned factual basis for the alternative scenarios that the court will have to consider and lay a cogent foundation to enable the court to determine that there [is] a reasonable prospect that the better return evident on one of those scenarios can be achieved. Vague and speculative averments in the founding papers will not suffice to provide a proper basis for a court to make the required determination that there is a reasonable prospect, if the company were to be placed under supervision, that the contemplated business rescue objective could be achieved.⁵⁰

The approach of the court in *Southern Palace* was, however, criticised in the *Prospec Investments case*.⁵¹ In relation to the threshold articulated in the earlier case regarding reasonable prospect, Van der Merwe J noted:

I agree that vague averments and mere speculative suggestions will not suffice in this regard. There can be no doubt that in order to succeed in an application for business rescue, the applicant must place before the court a factual foundation for the existence of a reasonable prospect that the desired object can be achieved. But with respect to my learned colleagues, I believe they place the bar too high.⁵²

Articulating the preferred approach, he said:

In my judgment it is not appropriate to attempt to set out general minimum particulars of what would constitute a reasonable prospect in this regard. It also seems to me that to require, as a

⁴⁷ At paras 24-5. This approach was affirmed by the same division in the later *Koen v Wedgewood case supra* at para 18; *AG Petzetakis International Holdings Limited v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ) of 6 February 2012 and *FirstRand Bank Ltd v Arbour Village (Pty) Ltd And Eii Holdings (Pty) Ltd v Arbour Village (Pty) Ltd* (2011/6253) [2013] ZAGPPHC 467 of 8 August 2013 at paras 8-9. The court at paras 12 & 17 in the latter case however cast doubt as to whether the latter objective (a higher return for creditors than in liquidation) could be used as a basis for supporting an application. The approach in *AG Petzetakis* was followed in the later *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Ltd) (in liquidation) and Others* (WCHC) unreported case no. 19599/2012 of 30 January 2013. The same question received brief consideration from the Gauteng High Court in *Burmeister and Another v Spitskop Village Properties Ltd and Others supra* at para 19. The SCA in *Oakdene Square Properties (Pty) supra* at paras 26 and 27 has held that a business rescue which seeks to achieve a higher return for creditors than in liquidation (as opposed to seeking to return the company to solvency) to be a valid objective for instituting proceedings in terms of section 131(4).

⁴⁸ *DH Brothers supra* at para 13. The *dictum* in *Oakdene SCA* was cited with approval by the court in *Eveleigh v Dowmont Snacks (Pty) Ltd and Others* (11982/2013) [2014] ZAKZPHC 1 (22 January 2014) at para 24.

⁴⁹ *Southern Palace Investments 265 (Pty) Ltd supra*.

⁵⁰ *Koen supra* at paras 17-18.

⁵¹ *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and another* 2013 (1) SA 542 (FB) (28 June 2012).

⁵² *Prospec Investments supra* at para 11.

minimum, concrete and objectively ascertainable details of the likely costs of rendering the company able to commence or resume its business, and the likely availability of the necessary cash resource in order to enable the company to meet its day-to-day expenditure, or concrete factual details of the source, nature and extent of the resources that are likely to be available to the company...is tantamount to requiring proof of a probability, and unjustifiably limits the availability of business rescue proceedings.⁵³

The *dictum* in *Prospec Investments* has been cited with approval by the Supreme Court of Appeal in the *NewCity Group*⁵⁴ and *Oakdene Square Properties*⁵⁵ cases. The approach in *Prospec Investments* is reflective of the current legal position. It may be argued in the converse that even though the prevailing view has provided an outline of what reasonable prospect is not, no comprehensive description of what it is has yet been articulated. One may, however, confidently posit the view that it is settled law that the content of ‘reasonable prospect’ envisages a slightly lower threshold than articulated in *Southern Palace*.

⁵³ *Prospec Investments supra* at para 15.

⁵⁴ *NewCity Group (Pty) Ltd v Allan David Pellow NO* (577/2013) [2014] ZASCA 162 (1 October 2014) at para 16. The judgment was further cited in *Registrar of Banks v Dafel and Others* (64378/2013, 64380/2013, 64381/2013) [2014] ZAGPPHC 884 (13 November 2014) at para 42 where the court required that a draft business rescue plan with objectively ascertainable information accompany the application for rescue; *Ndakisa v Dokose Construction CC and Another* (2934/2015) [2015] ZAECGHC 79 (25 August 2015) (Unreported). In this case the court accepted the applicant’s basis for reasonable prospect without the applicant having submitted a draft plan; *Pouroullis v Market Pro Investments 106 (Pty) Ltd (South African Bank of Athens Ltd and Absa Bank Ltd* (20370/2015) [2016] ZAGPJHC 12 (12 February 2016)(Unreported); *AL MAYYA INTERNATIONAL LIMITED (BVI)(formerly AL MAYYA SOUTH AFRICA LIMITED (BVI)) v VALLEY OF THE KINGS THABA MOTSWERE (PTY) LTD and Others* (High Court of South Africa, Eastern Cape Division- East London) case numbers 926/2016 & 2226/16 of 23 September 2016 at para 38.

⁵⁵ *Oakdene Square Properties (Pty) Ltd supra* at paras 30 and 31; *Industrial Development Corporation of SA Limited and Another v Schroeder N.O and Others* (1958/2015) [2015] ZAECMHC 65 (17 September 2015) at paras 36-37; *Dolphin Management and Others v Belmont Development Company (Pty) Limited and Others* (4704/2015) [2015] ZAECGHC 151 (10 December 2015).

4.2.4. CREDITOR

Despite reference to a ‘creditor’ as one of the categories of persons who may initiate proceedings by court order, the Act⁵⁶ does not provide a definition for the term. A creditor is included in the definition of ‘affected persons’.⁵⁷ It was defined in the Companies Bill⁵⁸ but has since been omitted.⁵⁹ In terms of section 130(1)(c) of the Companies Bill, a ‘creditor’ is defined as

... a person to whom a company owes money under any arrangement immediately before the beginning of the company’s business rescue proceedings, and for greater certainty, does not include a person who provides post-commencement finance to the company, as contemplated in section 138, except to the extent that such a person was a creditor of the company before providing that post-commencement finance...⁶⁰

A possible reason for its omission from the Act is advanced by Loubser⁶¹ who observes three primary deficiencies in the manner in which it was defined in the Bill. The first is that it specifically referred to persons to whom *money* was owed.⁶² This excluded instances where a creditor became such as a result of outstanding *services* or counter-performance due by the company.⁶³ Reference to an ‘arrangement’ was found to limit an obligation to instances where there had been an express *agreement*, whereas the same obligation may have been due to a court order.⁶⁴ The commentator observes that reference to post-commencement financing added further confusion to what was a somewhat circular definition.⁶⁵

The Companies Act defines an ‘independent creditor’ as:

...a person who
(i) is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2); and
(ii) is not related to the company, a director, or the practitioner, subject to subsection (2)...⁶⁶

An employee’s employment in a debtor company does not negate the latter’s independence simply by virtue of the relationship of employment.⁶⁷ Even though

⁵⁶ Act 71 of 2008.

⁵⁷ Section 128 of the Companies Act defines an ‘affected person’ as a ‘(i) shareholder or creditor of the company (ii) any registered trade union representing employees of the company and (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives...’ The South African Concise Oxford Dictionary (Oxford University Press Southern Africa Tenth Impression 2009) at 271 defines a creditor as ‘a person or company to whom money is owing.’

⁵⁸ Companies Bill B 61A-2008.

⁵⁹ It seems to have been replaced with the term ‘independent creditor’.

⁶⁰ Companies Bill B 61A-2008.

⁶¹ Loubser (2010) at 53.

⁶² My emphasis. Loubser (2010) at 53.

⁶³ My emphasis. Loubser (2010) at 53.

⁶⁴ My emphasis. Loubser (2010) at 53.

⁶⁵ Loubser (2010) at 53.

⁶⁶ Companies Act 71 of 2008, section 128(1)(g).

‘independent creditor’, in comparison to the definition of ‘creditor’ in the Bill, is not as substantively defined in the Act, it is not to be inferred that the definition is without purpose.

In *Absa Bank v NewCity*⁶⁸ the court describes the direction that the new Companies Act has taken in re-invigorating the definition of a creditor, and how this would come to yield to a seemingly amorphous concept of public interest when compared to its predecessor, judicial management:

In plain terms, it seems now to be incorrect to speak of an ‘entitlement’ to a winding up order simply because the applicant is an unpaid creditor. The rights of creditors no longer have pride of place and have been levelled with those of shareholders, employees, and with the public interest too...The norm that infuses the law about governance of companies after the advent of the Companies Act, 2008, means that creditor supremacy is over...⁶⁹

It is submitted that the ‘public interest imperative’, which has received discussion in Chapters 1 and 2, has resulted in a metamorphosis of the traditional conception of the ‘creditor as lender’ into the ‘employee as creditor, with pride of place’ particularly within the context of company rescue as a result of the company law reform process. It may be argued that a similar trend, although to a lesser degree, is observable in the context of the various reforms incrementally introduced in insolvency law.⁷⁰

4.3. INITIATING BUSINESS RESCUE PROCEEDINGS

The Act provides for business rescue proceedings to be initiated by resolution of the company’s board⁷¹ or upon the granting of a court order.⁷² Whether through board resolution or court order, the Act requires that business rescue proceedings endure for a maximum period of three months.⁷³ Where proceedings endure for a longer period, the practitioner is required to prepare a monthly report and deliver it to every affected person and (i) the court, where proceedings were initiated by court application⁷⁴ or (ii)

⁶⁷ Companies Act 71 of 2008, section 128(2).

⁶⁸ *ABSA Bank v Newcity Group (Pty) Ltd and another related matter* [2013] 3 All SA 146.

⁶⁹ At para 31-32.

⁷⁰ This aspect has received discussion in Chapter 3.

⁷¹ Companies Act 71 of 2008, Section 129.

⁷² Companies Act 71 of 2008, Section 131.

⁷³ Companies Act 71 of 2008, Section 132 (3). This timeline is applicable where proceedings have not ceased through termination by the practitioner, through application to court for termination by an affected person in conjunction with (or excluding) a liquidation order, through the filing of a substantial implementation notice by the practitioner or where the practitioner applies for termination (and or liquidation) as a result of a failure by creditors to adopt the rescue plan. Proceedings may endure for a longer period where the practitioner has requested an extension through court application.

⁷⁴ Section 132(3)(a) & (b)(i).

the Commission, where proceedings were originally initiated by board resolution.⁷⁵ The procedures through which proceedings may be initiated are discussed next.⁷⁶

4.3.1 COMMENCEMENT BY BOARD RESOLUTION

The applicable provision⁷⁷ in relation to initiating rescue proceedings by board resolution reads as follows:

- (1) Subject to subsection (2)(a), the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that—
 - (a) the company is financially distressed; and
 - (b) there appears to be a reasonable prospect of rescuing the company.
- (2) A resolution contemplated in subsection (1)—
 - (a) may not be adopted if liquidation proceedings have been initiated by or against the company; and
 - (b) has no force or effect until it has been filed.
- (3) Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must—
 - (a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and
 - (b) appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.
- (4) After appointing a practitioner as required by subsection (3)(b), a company must—
 - (a) file a notice of the appointment of a practitioner within two business days after making the appointment; and
 - (b) publish a copy of the notice of appointment to each affected person within five business days after the notice was filed.
- (5) If a company fails to comply with any provision of subsection (3) or (4)—
 - (a) its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity; and
 - (b) the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a court, on good cause shown on an ex parte application, approves the company filing a further resolution...

The company's board may resolve to commence proceedings provided that liquidation proceedings have not been initiated.⁷⁸ The board must resolve as a

⁷⁵ Section 132(3)(a) & (b)(ii). Even though the requirement of delivery of a progress report to the court or commission may arguably have been designed as a monitoring mechanism, it is currently unclear whether these institutions are reading progress reports delivered and if they are, what action is expected from them. Institutional capacity will have to be strengthened in CIPC, especially in light of the regulatory function imposed on it by the Companies Act, see 'regulatory authority' in section 1 read with section 185 of Companies Act of 2008. See further the definition of a 'regulatory agency' in Regulation 2(f) in the Companies Regulations, 2011.

⁷⁶ There seems to be a grey area in the Act as it may be observed that despite section 132's prescriptive nature in terms of timeline and requirement of a court order where a 3 month period has been exceeded, section 150(5) allows for a delay in plan publication through, *inter alia*, creditor consent. A creditor-sanctioned extension may well exceed 3 months and court sanction would not be necessary. In addition, it may be observed that the Act does not state the consequences of non-compliance with this provision. As will be seen from a discussion of the recent case law below, provisions relating to plan publication have been further relaxed.

⁷⁷ Companies Act 71 of 2008, Section 129.

collective rather than individually.⁷⁹ A moratorium takes effect on the date of filing of the resolution and is further discussed later in the chapter.⁸⁰ The board must ensure that the entity is both ‘financially distressed’ as well as meeting the requirements set out in the definition of ‘business rescue’.⁸¹ It has been argued that in initiating proceedings, the board is under no legal duty to consult with its shareholders.⁸² This view seems to accord with section 129, as the provision does not require the consent of shareholders in order for proceedings to be initiated. A justification for this approach has been grounded on the need to minimise delay and cost.⁸³

4.3.1.1 NON-COMPLIANCE WITH SECTION 129

Section 129 imposes strict time limits in order to reduce possible delay and abuse of process and provides that non-compliance with time limits results in a lapsing of proceedings, nullifying them.⁸⁴ This is however to be contrasted with section 130 (1), which provides that:

- (1) Subject to subsection (2), at any time after the adoption of a resolution in terms of section 129, until the adoption of the business rescue plan in terms of section 152, an affected person may apply to court for an order—
 - (a) setting aside the resolution, on the ground that...
 - (iii) the company has failed to satisfy the procedural requirements set out in section 129...⁸⁵

Section 218(1) is also relevant:

- (1) Subject to any provision in this Act specifically declaring void an agreement, resolution or provision of an agreement, Memorandum of Incorporation, or rules of a company, nothing in this Act renders void any other agreement, resolution or provision of an agreement, Memorandum of Incorporation or rules of a company that is prohibited, voidable or that may be declared unlawful in terms of this Act, unless a court has made a declaration to that effect regarding that agreement resolution or provision.⁸⁶

⁷⁸ See *Sulzer Pumps (South Africa) (Pty) Ltd v O & M Engineering* (High Court of South Africa, Gauteng Division) case no. 19740/2014 of 11 February 2011 at paras 25 & 30. See further *Lazenby v Lazenby Vervoer and Others* (High Court of South Africa: North West High Court) case no. M28/2014 of 4 September 2014 on the limitations of a director’s ability to initiate proceedings in terms of s 131 where business rescue had previously been initiated in terms of section 129.

⁷⁹ The provisions of section 73 and 74 of the Companies Act of 2008 would apply to such meeting in relation to quorum and voting. Failure to act in good faith on the part of the relevant directors may result in a cost order being awarded against the director(s), section 130(5)(c). See further *Griessel and Another supra* at paras 82 and 83.

⁸⁰ Section 129(2) read with section 132(1)(a)(ii).

⁸¹ See section 129(7) which requires the board of directors to deliver a written notice to affected persons where the board, despite having reasonably believed the company to be in financial distress, decides not to adopt the board resolution in terms of section 129(1) & (2).

⁸² Cassim (2012) at 866.

⁸³ Cassim (2012) at 866.

⁸⁴ Companies Act 71 of 2008, section 129(5).

⁸⁵ Companies Act 71 of 2008.

⁸⁶ Companies Act 71 of 2008.

The provision refers to making void certain legal engagements while section 129(5) refers to a lapsing and nullity. The difference in terminology cannot be ignored. Whether the legislative drafters intended these terms to be applied synonymously is unclear. Depending on the manner in which the words ‘nullify’, ‘lapse’ and ‘void’ are interpreted, a declaratory order confirming invalidity may have to be applied for by a creditor.

The sections may be reflective of a possible drafting inconsistency and have resulted in confusion in practice. The confusion relates to the moment at which proceedings become nullified, where non-compliance with time formalities in terms of section 129 has been identified. The question which arises is whether, where there is a failure to comply with section 129, the proceedings nullify as a matter of fact upon non-compliance or should a party lodge an application *seeking* a declaratory order confirming invalidity?

These are important questions which have a tremendous effect on the ailing company and its creditors. The courts have repeatedly affirmed a legislative preference for the rescuing of companies rather than their liquidation.⁸⁷ This imperative, however, must be seen in light of the desire to balance stakeholder interests as expressed in the Act’s purpose provisions⁸⁸ discussed in Chapter 1. An additional complexity is that creditors often do not stand on equal footing, where some stand to gain more from liquidation than a business rescue and *vice versa*. Even though courts have in many instances provided insights in terms of reconciling this inconsistency, they have often (and perhaps deliberately) missed the opportunity to provide definitive guidance on this aspect as shown in the following cases.

In *Advanced Technologies*⁸⁹ the court affirmed the position that

...the relevant sections contained in chapter 6 that a substantial degree of urgency is envisaged once a company has decided to adopt the relevant resolution beginning business rescue proceedings. The purpose of s 129 (5), is very plain and blunt. There can be no argument that substantial compliance can ever be sufficient in the given context. If there is non-compliance with section 129(3) or (4) the relevant resolution lapses and is a nullity. There is no other way out, and no question of any condonation or argument pertaining to “substantial compliance”. The requirements contained in the relevant sub-sections were either complied with or they were not...⁹⁰

⁸⁷ See *Southern Palace Investments 265 (Pty) Ltd supra*; *Koen supra* at para 14.

⁸⁸ Companies Act 71 of 2008, section 7.

⁸⁹ *Advanced Technologies and another v Aeronautique et Technologies and others* (North Gauteng High Court) case no. 72522/11 of 6 June 2012.

⁹⁰ At para 27.

Where non-compliance with section 129 results in a nullity as a matter of fact, a creditor is able to assert its rights by enforcing its claim against the defaulting debtor company without undue delay. This may, however, have the potential of prejudicing the already struggling company, forcing it into liquidation whereas it possesses great recovery potential. A possible response may be that an ‘affected person’ may request that the company be placed under business rescue⁹¹ by court application even where an application for liquidation has commenced or has been granted.⁹² The Act is clear that an application for business rescue and the granting thereof has the effect of suspending liquidation proceedings.⁹³

Where a declaratory order is required to confirm the nullity referred to in section 129 (a), this may potentially have a prejudicial effect on a creditor as a business rescue practitioner may, upon notice of application to declare proceedings a nullity, file an *ex parte* application for permission to file a further resolution.⁹⁴ In addition, there may be additional litigation costs associated with filing an application seeking a declaratory order by an already (and potentially) cash-strapped creditor.

Section 130(1)(a)(iii) is couched in permissive rather than peremptory language and states that an affected person *may* make application for such order.⁹⁵ Meskin *et al*⁹⁶ argue as follows:

It is difficult to align the apparent automatic lapsing of a business rescue resolution under the provisions of s 129 (5) with this provision. In terms of s 129 (5) it would appear that no Court application, or indeed any action at all, is required for the business rescue resolution to lapse and become a nullity where the procedural requirements of s 129 have not been met. Under s 130 (1) (a) (iii) an affected person may approach the Court for an order setting aside the business rescue resolution on the grounds that the company has failed to satisfy the procedural requirements set out in s 129.⁹⁷

They observe the dangers of an interpretive approach favouring an automatic lapsing and express their preferred approach as follows:

The approach under s 130 (1) seems a far more sensible approach in providing clarity regarding the status of the business rescue resolution than the situation catered for under s 129 (5).⁹⁸

⁹¹ In terms of section 131.

⁹² Provided that the prerequisites for business rescue, discussed earlier, have been met cf *Absa Bank v Makuna Farm CC* (South Gauteng High Court) case no. 2012/28972 of 30 August 2015. It must be noted that this may, however, result in additional costs attendant upon court applications. The consequences of *Lazenby v Lazenby Vervoer and Others supra* would need to be taken into account.

⁹³ Companies Act 71 of 2008, section 131(6). See the *Richter and Absa Ltd v Makuna Farm CC* cases discussed below.

⁹⁴ Companies Act 71 of 2008, section 129(5)(b).

⁹⁵ My emphasis.

⁹⁶ Meskin *et al Henochsberg on the Companies Act of 2008* Issue 9 accessed online on 12 October 2014 available at: <http://www.mylexisnexis.co.za.ezproxy.uct.ac.za/Index.aspx>.

⁹⁷ At page 459.

⁹⁸ *Henochsberg* Issue 9 at 461.

The *Advanced Technologies* judgment was subsequently confirmed In *Madodza*⁹⁹. In *DH Brothers Industries*¹⁰⁰ the potentially intrusive nature of the moratorium taking effect and the consequent limitations it places on the enforceability of a creditor's rights during proceedings was observed. The court emphasised the common law doctrine that legislative intrusion on existing rights should be read restrictively.¹⁰¹ It was further emphasised that the time-bound nature of proceedings as well as the need for an expeditious approach to business rescue was a way of limiting the legislative incursion on creditor rights.¹⁰²

On the possible consequences of non-compliance with time limits in section 129, Gorven J remarked:

I favour the approach that the failure to publish a plan within the given or extended period results in the termination of business rescue proceedings. This has the benefit of allowing creditors to enforce their rights against the company as soon as the time elapses. The need for certainty is met and the rights of creditors in particular are trespassed on to the least possible extent.¹⁰³

In *Absa Bank limited v Caine N.O*¹⁰⁴ this inconsistency received the attention of the court.¹⁰⁵ Despite having held that there was cogent authority for the view that the business rescue proceedings had lapsed or become a nullity, the court held that due to the circumstance of the case, the better approach would be to issue a declaratory order confirming invalidity based on non-compliance with other requirements of the Act.¹⁰⁶ In a recent appeal judgment, the Supreme Court of Appeal in *Panamo Properties (Pty) Ltd*¹⁰⁷ has resolved uncertainty around the application of sections 129 and 130 as well as the inconsistency observed by courts in earlier cases. Interpreting the relevant provisions, the court held as follows:

...when a court grants an order in terms of s 130(5)(a) of the Act, the effect of that order is not merely to set the resolution aside, but to terminate the business rescue proceedings. *A fortiori* it

⁹⁹ *Madodza (Pty) Ltd v ABSA and others* (North Gauteng High Court) case no. 38906/2012 of 15 August 2012.

¹⁰⁰ *DH Brothers Industries (Pty) Ltd supra*.

¹⁰¹ At para 26.

¹⁰² At para 27. In the earlier *Koen case* at para 10 the court made similar observations:

‘...It is axiomatic that business rescue proceedings, by their very nature, must be conducted with the maximum possible expedition...Legislative recognition of this axiom is reflected in the tight timelines given in terms of the Act for the implementation of business rescue procedures if an order placing a company under supervision for that purpose is granted. There is also the consideration that the mere institution of business rescue proceedings - however dubious might be their prospects of success in a given case - materially affects the rights of third parties to enforce their rights against the subject company...’

¹⁰³ At para 28.

¹⁰⁴ *Absa Bank limited v Caine N.O* (High Court of South Africa Free State Division) case nos. 3813/2013 & 3915/2013 of 2 April 2014.

¹⁰⁵ *Absa Bank limited v Caine N.O* (High Court of South Africa Free State Division) case nos. 3813/2013 & 3915/2013 of 2 April 2014 at para 25.

¹⁰⁶ At para 56; See also *Homez Trailers And Bodies (Pty) v Standard Bank of South Africa Ltd* (35201/2013) [2013] ZAGPPHC 465 (27 September 2013).

¹⁰⁷ *Panamo Properties (Pty) Ltd v Nel and Another NNO* (35/2014) 2015 ZASCA 76 (27 May 2015).

follows that until that has occurred, even if the business rescue resolution has lapsed and become a nullity in terms of s 129(5)(a), the business rescue commenced by that resolution has not terminated...¹⁰⁸

In relation to previous judgments on this point, the following comments were made:

The assumption underpinning the various high court judgments to the effect that the lapsing of the resolution terminates the business rescue process is inconsistent with the specific provisions of the Act...¹⁰⁹

The court emphasised that, as a corollary, where non-compliance with section 129(3) or (4) had been identified, a court would have to be approached for the resolution to be set aside and proceedings terminated.¹¹⁰ Notwithstanding the insights provided by the court on this aspect, an opportunity to provide guidance regarding the practical legal effect of the ‘lapsing’ and ‘nullity’ referred to in those sections has been missed. Apart from the observation that these were aspects that enabled an applicant to apply for a termination in terms of section 130, no content was provided regarding the legal implications of a supposed lapse or nullity. It is my view that the court’s interpretation has effectively rendered section 129(5) superfluous. The court explained its approach:

One further point in favour of this approach is that it largely precludes litigants, whether shareholders and directors of the company or creditors, from exploiting technical issues in order to subvert the business rescue process or turn it to their own advantage...the scope for raising technical grounds to avoid business rescue will be markedly restricted even if it does not vanish altogether...¹¹¹

For reasons advanced in the brief critique of the *Panamo Properties* judgment, both at this stage and as will be seen later in the chapter, even if it is accepted that in adopting this approach the court has placed a high premium on the rescuing of companies in general, it remains doubtful that in giving effect to the rescuing of companies as required by section 7, it has done so in a manner that balances the rights and interests of all relevant stakeholders as mandated by that provision.

¹⁰⁸ *Panamo supra* at para 28.

¹⁰⁹ *Panamo supra* at para 28.

¹¹⁰ *Panamo supra* at para 30.

¹¹¹ *Panamo supra* at para 34.

4.3.2 OBJECTION TO RESOLUTION COMMENCING PROCEEDINGS

An affected person may make application to court for the purposes of setting aside the company resolution initiating business rescue proceedings.¹¹² This right is exercisable from the period after adoption and filing of the resolution as required by section 129 until prior to the adoption of the business rescue plan by creditors.¹¹³

An applicant may seek an order setting aside the resolution on ground that (i) there are no reasonable grounds for believing the company to be financially distressed¹¹⁴, (ii) that despite the possible existence of financial distress, there are no reasonable prospects of the company being rescued¹¹⁵ or (iii) where the company has failed to satisfy the procedural prescripts of section 129.¹¹⁶ The applicant may further request that the practitioner's appointment be set aside on a number of grounds and the court may make an order setting aside the resolution or appointment of the practitioner.¹¹⁷

4.3.3 COMMENCEMENT BY COURT ORDER

Business rescue proceedings may, in addition, be commenced by court order. The applicable provision reads:

131. (1) Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court at any time for an order placing the company under supervision and commencing business rescue proceedings.
- (2) An applicant in terms of subsection (1) must—
- (a) serve a copy of the application on the company and the Commission; and
 - (b) notify each affected person of the application in the prescribed manner.
- (3) Each affected person has a right to participate in the hearing of an application in terms of this section.
- (4) After considering an application in terms of subsection (1), the court may—
- (a) make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that—
 - (i) the company is financially distressed;
 - (ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
 - (iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company...¹¹⁸

¹¹² Companies Act 71 of 2008, section 130. See *The Commissioner SARS v The Business Zone 983 CC* (9673/2015) [2015] (7 September 2015). On the effects of a non-joinder of creditors where an applicant had sought to set aside a business rescue plan and the applicable test in such circumstances, see *Absa Bank Ltd v Naude N.O. and Others* (20264/2014) [2015] ZASCA 97 (1 June 2015). Subsequently followed in *Stalcor (Pty) Ltd v Kritzingers NO and Others* (1841/2012) [2016] ZAFSHC 6 (21 January 2016) at para 44.

¹¹³ See *Ex parte Nel NO and Others* (High Court of South Africa, Gauteng Division, Pretoria) unreported case no. 45279/14 of 28 July 2014, where the court considered the novel question of the effect of a section 129(1) resolution commencing proceedings being set aside and the company placed in final liquidation, particularly where an appeal against such order was lodged.

¹¹⁴ Companies Act 71 of 2008, section 130(1)(a)(i).

¹¹⁵ Companies Act 71 of 2008, section 130(1)(a)(ii).

¹¹⁶ Companies Act 71 of 2008, section 130(1)(a)(iii).

¹¹⁷ Companies Act 71 of 2008, sections 130(1)(b) and 130(5).

¹¹⁸ Companies Act of 2008.

The section provides for commencement of proceedings where the company's board has not passed a resolution in terms of section 129.¹¹⁹ Application to court may be made by an 'affected person' consisting of a shareholder, creditor, registered trade union representing employees, and employees in their individual capacities.¹²⁰ As with the section 129 procedure, notification requirements find application.¹²¹ The costs of the application are often borne by the company to be placed in business rescue where the applicant has been successful even though the court has inherent jurisdiction to determine the awarding of costs.¹²²

The consequence of commencement by court order becomes visible when analysing its effect on liquidation proceedings which may have already commenced:

- (6) If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until—
 - (a) the court has adjudicated upon the application; or
 - (b) the business rescue proceedings end, if the court makes the order applied for...¹²³

A moratorium on all claims or actions against the company comes into effect upon the issuing of the application by the Registrar of the High Court.¹²⁴ In an application for business rescue by court order there is a time lag between the moratorium coming into effect and actual commencement of proceedings.¹²⁵ Application may be made despite liquidation proceedings having been initiated or being in force.¹²⁶

The granting of the application in favour of business rescue suspends liquidation.¹²⁷ Proceedings may again be initiated only once business rescue has

¹¹⁹ Companies Act 71 of 2008, section 131(1).

¹²⁰ Companies Act of 2008, section 128(1)(a) read with section 131(1). It must be shown that business rescue will enable the company to continue on a solvent basis or, at minimum, derive a better dividend for creditors than in liquidation. See *Swart v Beagles Run Investments 25 (Pty) Ltd (First Rand Bank Ltd and others intervening)* 2011 5 SA 422 (GNP) (30 May 2011).

¹²¹ Sub-section (2). On the legal consequences of non-compliance with notice requirements in section 131(2) read with regulation 7 and a brief critique of regulation 124, see *Cape Point Vineyards (Pty) Ltd supra* at paras 13-16; *Kalahari Resources (Pty) Ltd v Arcelormittal S.A and Others* (South Gauteng High Court, Johannesburg) case no. 12/16192 of 26 June 2013 at paras 57-63.

¹²² For authority on the question of who ought to bear costs in an application for business rescue, see *Cape Point Vineyards (Pty) Ltd supra* at paras 4-5. See generally on costs *Bambanani Fruits Holdings (Pty) Ltd v Bambanani Farming Operations (Pty) Ltd* (2839/2013) [2013] ZAFSHC 196 (15 November 2013).

¹²³ Companies Act 71 of 2008, section 131.

¹²⁴ See Cassim *et al Companies and Other Business Structures* (2009) Oxford University Press: South Africa at page 169-170.

¹²⁵ See section 131(1) read with 132(1)(b). This aspect is canvassed in the section discussing the moratorium.

¹²⁶ Companies Act 71 of 2008, section 131(6).

¹²⁷ Companies Act 71 of 2008, section 131(6).

terminated in terms of section 132(2). The right of an affected person to intervene in such application has been affirmed by the court in *Everleigh v Dowmont*.¹²⁸ There has been disagreement, regarding interpretation of the phrase ‘If liquidation proceedings have already commenced’.¹²⁹ The disagreement relates primarily to the scope of the term ‘commenced’¹³⁰ as well as the moment at which a company in liquidation may be said to no longer be capable of having recourse to rescue proceedings. It is to be appreciated that the question has profound implications on the rights of creditors and on the company.

In *Van Staden*¹³¹ it was held that even though a distinction could be drawn between legal proceedings relating to a winding up and a winding-up as overseen by liquidators, winding-up is a continuation of liquidation proceedings and that proceedings only come to an end where a final liquidation and distribution account is submitted and confirmed by the Master.¹³² The court found that where the practitioner formed the view that rescue proceedings would not be viable in a specific case, the company would revert to liquidation with a limited amount of costs having being

¹²⁸ See *Everleigh supra* at para 19.

¹²⁹ My emphasis.

¹³⁰ A related aspect was the question whether ‘liquidation proceedings’ related to the procedural aspect of acquiring a liquidation order or to substantive liquidation proceedings following the granting of a final order of liquidation. See the *Makuna Farm CC and Richter cases supra*.

¹³¹ *Van Staden v Angel Ozone Products CC* (Gauteng North, Pretoria) case no. 54009/11 of 10 October.

¹³² See further *Absa Bank Ltd v Summer Lodge (Pty) Ltd* case nos. 63188/2012, 63189/2012 & 63190/2012 [2013] ZAGPPHC 544 (23 May 2013) at paragraphs 12 - 18; *Firststrand Bank Ltd v Imperial Crown Trading 143 (Pty) Ltd* 2012 (4) SA 255 (15 December 2011). In addition to drawing a distinction between the application of sections 129 and 131, the court found that an order for liquidation did not prevent a subsequent application for business rescue. It granted the provisional liquidation order with an extended return date so as to permit the company time to make application for business rescue proceedings. The approach is to be contrasted with *Sibakhulu Construction v Wedgewood Village Golf Country Estate (Pty) Ltd (Nedbank Intervening)* [2011] ZAWCHC 439 WCC (16 November 2011) where the court was not prepared to grant a provisional liquidation order. See *Taboo Trading 232 (Pty) Ltd v Pro Wreck Scrap Metal CC* (Kwazulu Natal Provincial Division) case no. 6366/13 of 10 July 2013 on the importance of complying with the procedural requirements set out in section 131. The court in *Pro Wreck*, at para 11.4, held that a business rescue application must be regarded as having been made only once the application is lodged with the Registrar, duly issued and served on the Commission and every affected person. See further *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* (2544/2013) [2013] ZAWCHC 136; 2013 (6) SA 540 (WCC) (23 August 2013) at para 29 where the court held that in applying the functional approach, lodging the application with the Registrar constitutes ‘making’ the application in terms of section 131(6). The decision in *Taboo* and *Summer lodge* cases *supra* was followed in *Standard Bank of South Africa Limited v Gas 2 Liquids (Pty) Limited* (45543/2012) [2016] ZAGPJHC 38 (10 March 2016) albeit for different reasons. See further *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 (18 April 2012); *The Employees of Solar Spectrum Trading 83 v Afgri Operations Ltd and another* (North Gauteng High Court, Pretoria) case numbers 6418/12, 18624/2011 and 66226/2011 of 8 May 2012; *ABSA Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group (Pty) Ltd & Another supra*.

incurred.¹³³ The court allowed the application for business rescue despite liquidation proceedings having progressed to an advanced stage.¹³⁴

A different conclusion was reached by the court in *Absa Bank v Makuna Farm*.¹³⁵ Concluding that winding up proceedings only commenced once a winding up order was granted, the court held that the words ‘liquidation proceedings’ referred to proceedings following the granting of the order and not the application lodged for the purposes of obtaining an order.¹³⁶ The court had no difficulty in finding that in applying for the final-order of winding up, the respondent was not barred by provisions of section 131(6).¹³⁷

This approach provides a level of much needed certainty and further curtails the prospect of abuse. By the time a final order has been granted (even before the final liquidation and distribution account has been lodged at the Masters Office) many fees and costs would have been incurred in winding up a company’s estate. An interpretation that leaves section 131(1) & (6) open-ended may prejudice a number of parties.

The position has been settled by the Supreme Court of Appeal in the *Richter v ABSA Bank case*¹³⁸. The Supreme Court of Appeal rejected the approach in the *Bloempro and Molyneux cases* as well as the decision of the court *a quo*. In this case, application for business rescue proceedings in terms of section 131 was made after a final order of liquidation was granted. Observing that the terms ‘liquidation’ and ‘winding-up’ had historically been used interchangeably within the context of a company being dissolved, the court held that no significant distinction could be drawn between the term ‘liquidation’ and the phrase ‘liquidation proceedings’.¹³⁹ The court concluded that a proper interpretation of ‘liquidation proceedings’ in terms of section

¹³³ *Van Staden supra* at para 34.

¹³⁴ *Van Staden supra* at paras 30 & 32.

¹³⁵ *Absa Bank v Makuna Farm CC supra*. The same approach was followed by the court in *ABSA Ltd v Summer Lodge supra*.

¹³⁶ *Makuna Farm CC supra* at para 7.

¹³⁷ *Makuna Farm CC supra* at paras 7-8. A similar approach was followed in the *Richter v Bloempro CC and Others* (North Gauteng Division) case no. 69531/2012 of 14 March 2014. The court further rejected the earlier approach of the court in *Absa Bank v Summer Lodge (Pty) Ltd* 2013 (5) SA 444 (GNP). The *Summer Lodge* approach was also criticised in *ABSA Bank Limited v Cardio Fitness Properties* (GSJ) case no. 2008/12 of 28 November 2013. See further *Janse van Rensburg NO & Another v Cardio Fitness Properties (Pty) Ltd & Others* [2014] ZA GPJHC 40 4 March 2014. On the effect of a liquidation on a company’s ‘residence’ and ‘principal place of business’, see *PMG Motors v First Rand Bank* (866/2013) [2014] ZASCA 180 (24 November 2014) at paras 12-13.

¹³⁸ *Richter v ABSA Bank Limited* (20181/2014) [2015] ZASCA 100 (1 June 2015). See further *Standard Bank of South Africa Ltd v A-Team Africa Trading CC* (7233/15) [2015] ZAKZPHC 51.

¹³⁹ *Richter v ABSA supra* at para 11.

131(6) included proceedings following the granting of a final liquidation order until the deregistration of the company.¹⁴⁰

Unlike commencement by board resolution, commencement by court order contains an additional ground on which the court may grant an order for business rescue. This is where the court considers that it is ‘just and equitable’ to do so for financial reasons.¹⁴¹ Notwithstanding the additional ground on which the application may be granted, an applicant must satisfy the court that a reasonable prospect for rescuing the company exists.¹⁴²

Despite the presence of mechanisms which allow for initiating business rescue through court process, proceedings have, unlike those in terms of the Bankruptcy Code, been described as largely non-interventionist in nature.¹⁴³ Even though this change in approach has been accepted in a positive light (due to its perceived cost saving nature), some have argued that less involvement on the part of the courts would imply less accountability during the process, possibly proving detrimental to the interests of creditors.¹⁴⁴ A discussion of management control during proceedings follows.

4.4. MANAGEMENT-CONTROL OF THE COMPANY DURING PROCEEDINGS

4.4.1 THE PRACTITIONER

The business rescue practitioner is tasked with the responsibility of achieving the purpose of business rescue.¹⁴⁵ The practitioner is described as

...a person appointed, or two or more persons appointed jointly, in terms of this Chapter to oversee a company during business rescue proceedings and the ‘practitioner’ has the corresponding meaning...¹⁴⁶

¹⁴⁰ At para 18. This view has been cited with approval in the recent *Burmeister and Another v Spitskop Village Properties supra* where the court has remarked that the fact that a company was granted a final order of liquidation did not prevent the court from determining whether a company is financially distressed; *Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others* (4653/2015) [2015] ZAWCHC 90; [2015] 3 All SA 659 (WCC) (10 June 2015). See further the *obiter* remarks of the court in *Knipe and Others v Noordman NO and Others* (4817/2014) [2015] ZAFSHC 124 (25 June 2015); *Van Zyl v Engelbrecht* 2014 (5) SA 312 (FB).

¹⁴¹ Companies Act of 2008, section 131(4)(iii). *Kalahari Resources (Pty) supra* at paras 70.

¹⁴² Companies Act 71 of 2008, section 134(4)(a). The concept of a ‘reasonable prospect’ has been discussed earlier.

¹⁴³ Paul J Omar (ed) *International Insolvency Law: Themes and Perspectives* (2008) Aldershot: Ashgate Publishing at 122.

¹⁴⁴ Bradstreet (2011) at 362.

¹⁴⁵ Be it the primary or secondary purpose. See definition of ‘business rescue’ discussed earlier. This is only possible with the support of creditors and other affected persons.

¹⁴⁶ Companies Act of 2008, section 128(1)(d).

His/her responsibility entails developing and implementing a plan to rescue the company.¹⁴⁷ Upon appointment, the practitioner must investigate the affairs of the company and form a view as to whether the company has reasonable prospects of being rescued.¹⁴⁸ Conversely, directors of the company have a corresponding duty to assist the practitioner while conducting his/her investigations.¹⁴⁹ In addition to investigating the prospects of rescue, the practitioner is required to rectify any legal transgression or non-compliance.¹⁵⁰ This includes forwarding any information relating to illegality on the part of the company to the relevant authority.¹⁵¹

The practitioner takes over management and control of the company in substitution for its board and existing management and is as such vested with the powers of removal and/or appointment.¹⁵² The practitioner may, in addition to appointing management, approach the court to appoint persons to advise where such persons have had a previous relationship with the company.¹⁵³

The practitioner is an officer of the court.¹⁵⁴ Providing content to the term as well as corresponding duties flowing therefrom, the court in *Resource Washing*¹⁵⁵ decreed:

Essentially BRPs, like directors of the company, have non-negotiable fiduciary duties towards the company...The BRP may not be a dummy or puppet blindly following the instructions of a shareholder or anyone who appointed him. If he does so he commits a breach of his statutory duty. He also has a statutory duty to act bona fide in the best interests of the company irrespective of any contractual obligation he agrees to...¹⁵⁶

Unlike the position in comparative jurisdictions such as the U.K. and U.S., the practitioner does not have an underlying fiduciary duty towards the company's

¹⁴⁷ Section 128(d) read with sections 140(d), 150 and 152. For general reading on the proposed competencies of a business rescue practitioner see Marius Pretorius 'Tasks and activities of the business rescue practitioner: a strategy as practice approach' (2013) (University of Pretoria: Paper accepted in May 2013 for publication in the *South African Business Review*- Vol. 17 No.3 December 2013).

¹⁴⁸ Companies Act 71 of 2008, section 141(1). See generally the observations of the court in *Jacobus Hendrikus Janse Van Rensburg v Nifdev (Pty) Ltd and Others* (Western Cape High Court) case no. 20300/15 of 21 December 2015.

¹⁴⁹ Companies Act 71 of 2008, section 142.

¹⁵⁰ This includes directing management to rectify non-compliance, see section 141(2)(c).

¹⁵¹ Such as fraud, reckless trading or other contravention.

¹⁵² This includes the power of delegation. Section 140(1). In relation to the practitioner's powers of delegation, see *Murgatroyd v Van Den Heever N.O and Others* [2014] 4 All SA 89 (GJ) at paras 16 & 17. See further Richard Bradstreet 'The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders' Willingness and the Growth of the Economy' (2010) 22 *SA Merc LJ* 195 at 200.

¹⁵³ Companies Act 71 of 2008, section 140(2)(a) & (b).

¹⁵⁴ Companies Act 2008, section 140(3)(a).

¹⁵⁵ *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015).

¹⁵⁶ *Resource Washing supra* at para 55. Where a practitioner acts improperly the court may grant a punitive cost order against him/her, see *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* [2015] ZASCA 69 (20 May 2015) at para 37-38.

creditors and that in practice this aspect has contributed to the often-perceived lack of impartiality on the part of some practitioners (whether apparent or real).¹⁵⁷ The position in these jurisdictions is discussed in the following chapter.

The definition of ‘business rescue’¹⁵⁸ enjoins the practitioner to implement measures, which seek to return the company to solvency as a primary objective. The Act vests the practitioner with the duties and liabilities of a director while the company remains in business rescue. The provisions of the 2008 Act in relation to directors’ standards of conduct require a director¹⁵⁹ to act in the interests of the *company* rather than to those of its *creditors*.¹⁶⁰ The practitioner must possess qualifications stipulated in the Act and may be removed on various grounds.¹⁶¹ Pretorius¹⁶² observes that even though Chapter 6 prescribes the functions to be performed by the practitioner during rescue, the chapter does not stipulate competencies which the practitioner should possess.¹⁶³ The manner in which the practitioner is appointed is regulated by section 129, where proceedings have been commenced by board resolution and section 131 where proceedings are commenced by court application.¹⁶⁴

The practitioner may partially, entirely or conditionally suspend contractual obligations to which the company was party at commencement of proceedings.¹⁶⁵ Where a cancellation of a contract to which the company was party is contemplated,

¹⁵⁷ The practitioner’s fiduciary duties are stipulated in section 140(3) of the 2008 Act.

¹⁵⁸ Discussed earlier.

¹⁵⁹ And a practitioner during business rescue proceedings.

¹⁶⁰ My emphasis. Companies Act of 2008, section 76(3).

¹⁶¹ The grounds for the practitioner’s removal have been briefly discussed in the context of objections that may be raised by an affected person. These are to be read with sections 138, 139 in conjunction with regulation 126. See *Resource Washing (Pty) Ltd supra* the court at para 56. In *Breedt v P G Breedts Boorkontrakteurs CC and Others* (10581 / 2012) [2013] ZAGPPHC 17 (4 February 2013) at para 16-17 the court seems to have found the perception of conflict as opposed to conflict proven through evidence as sufficient for finding the business rescue application to have been flawed.

¹⁶² Marius Pretorius ‘Business Rescue Status Quo report Final Report’ (University of Pretoria: Document Prepared for CIPC, 30 March 2015).

¹⁶³ Marius Pretorius ‘A competency framework for the business rescue practitioner profession’ (2014) *Acta Commerci* 14(2), Art. #227 at 15 where Pretorius observes that existing selection guidelines for practitioner appointments are at most aligned with generally defined competencies of leaders and change agents but are generally vague. In this work however, he highlights four higher-order competencies considered important for business rescue practitioners to have. These consist of sense-making, collaboration, decision making and integration. These, in Pretorius’ view, should enable the practitioner to navigate through the process and achieve the best alternative in the circumstances. For further reading on Business Rescue Practitioner competencies, see Marius, Pretorius ‘Tasks and activities of the business rescue practitioner: a strategy as practice approach’ (2013) Vol. 7 No. 3 *South African Business Review*.

¹⁶⁴ Both provisions have received discussion within the context of commencing proceedings.

¹⁶⁵ Companies Act 2008, section 136(2). Employees are protected by section 136(2A) from the practitioner’s powers of suspension and cancellation of employment contracts.

the court must be approached on application.¹⁶⁶

The courts have however lamented the limited powers vested upon the practitioner.¹⁶⁷ The following observations were made in *Oakdene*:

Sections 26-31 of the Insolvency Act of 1936 are available to a liquidator to impeach certain dispositions which are not available to a business rescue practitioner. The power of a business rescue practitioner to suspend “any obligation of the company that arises under an agreement” is highly contentious. It may lead to “cherry picking” where the practitioner selects certain obligation[s] best suited to the Company for suspension...¹⁶⁸

The Act¹⁶⁹ caters for removal of the practitioner by court order but does not expressly provide for a re-adoption of a company resolution and filing of a nomination for appointment, where a practitioner has simply absconded. Appointment of an alternative practitioner occurs on the assumption that the previous practitioner has been removed by court order from office¹⁷⁰ or has resigned.¹⁷¹ It seems that absent voluntary resignation or death, a declaratory order would be required from the court.¹⁷² Even though provisions relating to removal may be said to reflect a level of rigidity on the part of the Act, it may be justified on the basis that it incorporates an element of certainty and prevents possible abuse on the part of directors where they are not in agreement with the practitioner.

4.4.2 DIRECTORS

The Act envisages a co-operative relationship between the company’s directors or members and the practitioner once proceedings have commenced.¹⁷³ Directors have a duty to co-operate with the practitioner and are required to defer to his/her authority.¹⁷⁴ Conversely, the extent of the practitioner’s authority and power in

¹⁶⁶ Whether the cancellation is conditional, partial or a cancellation of the complete contract.

¹⁶⁷ In *Oakdene Square Properties at a quo supra* the court at para 49 briefly referred to the limitations to which the practitioner’s powers are subject when compared to his/her insolvency law counterpart, the liquidator.

¹⁶⁸ *Oakdene at a quo supra* at para 49.

¹⁶⁹ Section 139.

¹⁷⁰ By court on grounds listed in section 139(2).

¹⁷¹ Companies Act of 2008, sections 139(1)(a), 139(3) and section 139(3). Equally troubling is that the Act does not stipulate the time period within which a new practitioner must be appointed. It may be argued that with a moratorium still in force (notwithstanding, removal, resignation or death of a previously appointed practitioner) directors and managers may not have an incentive to relinquish power to a new practitioner.

¹⁷² It does not seem entirely clear from the section whether, having removed the practitioner, the court may substitute his/her appointment with another. Specific reference is made to the company or a nominating creditor as potential appointers. See section 139(3).

¹⁷³ Companies Act 71 of 2008, section 142. Cassim (2012) at 894 correctly observes: ‘...It must be stressed that, while the practitioner takes over the full management and control of the company, the pre-existing management is not completely displaced. It would continue to function during the process under the authority of the practitioner...’

¹⁷⁴ Companies Act 71 of 2008, section 137(2).

managing and controlling the company's affairs is evidenced by sub-sections 4 and 5.¹⁷⁵

Directors are required to respond positively to the practitioner's requests for information regarding the company's affairs.¹⁷⁶ Where a director hinders the exercise of the practitioner's functions or refuses to comply with a reasonable instruction, application may be made for that director's removal.¹⁷⁷ Where directors act without necessary approval from the practitioner, such act is legally void.¹⁷⁸ It may be argued that this also applies in the context of transactions with *bona fide* third parties transacting with the company.¹⁷⁹ The provisions, however, do not grant the practitioner *carte blanche* to do as he or she pleases. Restraints are placed by the Act on the practitioner's powers. A clear example is in section 137(5) which, despite the general powers vested in the practitioner in terms of section 140, require court sanction for certain acts.¹⁸⁰

4.5. THE MORATORIUM AND PROTECTION OF PROPERTY INTERESTS

The Act seeks to ensure a balance of stakeholder interests while allowing for the recovery of distressed businesses.¹⁸¹ The manner and degree to which this balance is achieved is critical to the entire scheme of business rescue. A moratorium on enforcement actions against the debtor company has a significant impact on creditors as stakeholders during proceedings. It is for this reason that it is discussed.

As with the U.K. administration procedure¹⁸², the Companies Act permits the application of interim and final moratoria. The interim moratorium finds application within the context of commencement through court application.¹⁸³ Once the application has been issued by the Registrar of the High Court, an interim moratorium comes into force and freezes all claims against the company.¹⁸⁴

At this stage, only an application has been made and business rescue proceedings have not yet formally begun. The application of the moratorium will

¹⁷⁵ Companies Act 71 of 2008, section 137.

¹⁷⁶ Companies Act 71 of 2008, section 137(3) read with section 142.

¹⁷⁷ Companies Act 71 of 2008, section 137(5).

¹⁷⁸ Companies Act 71 of 2008, section 137(4).

¹⁷⁹ Cassim (2012) at 888. Therefore these parties are expected to exercise caution when dealing with the board of directors during business rescue.

¹⁸⁰ Companies Act 71 of 2008, section 137(5) and 140(2)(a) & (b).

¹⁸¹ Companies Act 71 of 2008, section 7.

¹⁸² Discussed in Chapter 5.

¹⁸³ Companies Act 71 of 2008, section 132(1)(b). This is similar to the approach in the U.K. Insolvency Act.

¹⁸⁴ Companies Act 71 of 2008, section 133(1), unless falling under the exceptions therein.

either continue or cease, depending on whether or not proceedings receive sanction of the court. The interim moratorium therefore comes into operation before proceedings have officially commenced. It may further be observed that due to the often time-consuming nature of opposed applications, this avenue may be open to abuse by companies wishing to delay remedy enforcement by creditors or to delay the effect of a final order of liquidation by a competent court.¹⁸⁵

In relation to commencement by company resolution, a final moratorium takes effect on the date on which the resolution is filed with CIPC.¹⁸⁶ The moratorium is governed by section 133, which reads:

- (1) During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except—
 - (a) with the written consent of the practitioner;
 - (b) with the leave of the court and in accordance with any terms the court considers suitable;
 - (c) as a set-off against any claim made by the company in any legal proceedings, irrespective whether those proceedings commenced before or after the business rescue proceedings began;
 - (d) criminal proceedings against the company or any of its directors or officers; or
 - (e) proceedings concerning any property or right over which the company exercises the powers of a trustee...
- (2) During business rescue proceedings, a guarantee or surety by a company in favour of any other person may not be enforced by any person against the company except with leave of the court and in accordance with any terms the court considers just and equitable in the circumstances.
- (3) If any right to commence proceedings or otherwise assert a claim against a company is subject to a time limit, the measurement of that time must be suspended during the company's business rescue proceedings.

The moratorium extends over all claims against the company. As a result, a creditor is as a rule unable to enforce its claim.¹⁸⁷ The moratorium applies in favour of the company only and not to persons who may have executed suretyships for its

¹⁸⁵ Specifically in instances where there is some form of collusion between directors of the company and an affected person (for example, a non-independent creditor which may be a connected person or group company).

¹⁸⁶ In terms of section 129.

¹⁸⁷ Cassim (2012) at 880. Exceptions to this are listed in the section. The Act does however provide protection to creditors in that prescription in relation to a creditor's claim is suspended while the company is in rescue.

benefit.¹⁸⁸ Notwithstanding the wide application of the moratorium, certain divisions of the court have held that it does not apply to litigation against the business rescue plan, in contradistinction to a challenge to the procedure or the exercise of a remedy against the company's assets or those in its lawful possession.¹⁸⁹ In *Moodley* the following was observed:

The language of s 133, when read in context with other relevant provisions in Chapter 6 and having regard to its purpose, does not include within its ambit proceedings relating to the development, adoption or implementation of the business rescue plan...Legal proceedings, such as the present case, which seek that an adopted business plan be executed and implemented strictly in accordance with the provisions of the Companies Act, are legal proceedings against the business rescue practitioner and the company in business rescue in connection with the business rescue plan. They are not legal proceedings against the company or property belonging to the company or lawfully in its possession within the meaning of section 133(1).¹⁹⁰

Having reached this conclusion, the court found:

Section 133, therefore, finds no application in legal proceedings against a company in business rescue and its business rescue practitioner in connection with the business rescue plan, including its interpretation and execution towards implementation. [I] respectfully consider the contrary finding in *Redpath* to be clearly wrong and decline to follow it...¹⁹¹

¹⁸⁸ See *Investec Bank Ltd v Bruyns* (19449/11) [2011] ZAWCHC 423; 2012 (5) SA 430 (WCC) (14 November 2011) at paras 17- 23. The judgment was confirmed in *Kritzinger and Another v Standard Bank of South Africa* (3034/2013) [2013] ZAFSHC 215 (19 September 2013) at para 61. This issue has also been dealt with at length by the court in *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff and Another* (18136/13) [2014] ZAWCHC 78; 2014 (4) SA 521 (WCC); [2014] 3 All SA 500 (WCC) (28 May 2014) at para 14. The approach in *Tuning Fork* was criticised in an *obiter* remark of Wallis JA in *Newpoint Finance Co (Pty) Ltd v Nedbank Ltd* [2014] ZASCA 210 at para 14. See further the *obiter* remarks in *Absa Bank Limited v Haremza* (12189/2014) [2015] ZAWCHC 73 (27 May 2015). On an analysis of the cases it may be argued that, at minimum, the prevailing approach is that a surety cannot use the commencement of business rescue as a shield against liability. However, and more tentatively, where a debt is compromised in terms of a business rescue plan and in order for a creditor to retain the right to pursue the said surety, such right must be preserved notwithstanding the compromise of a claim as against the principal debtor in terms of the plan. Where the ambit of the suretyship agreement permits, a creditor may be entitled to excuss the surety for the full amount where the principal debtor is unable to pay its debt (provided that it is due and payable), even prior to business rescue proceedings commencing. This would, however, depend on the provisions of the suretyship agreement entered into. See further *Absa Bank Limited v Du Toit and Others* [2013] ZA WCHC 194 (13 December 2013) at para 18; *Business Partners Limited v Tsakiroglou & Tsakiroglou* (High Court of South Africa: Western Cape Division) case no. 17827/14 of 13 May 2015 at paras 29- 34. See further the *obiter* remarks of the court in *New Port Finance Company (Pty) Ltd and Another v Nedbank Ltd; Mostert and Another v Nedbank Ltd* [2015] JOL 32610 (SCA).

¹⁸⁹ In *Redpath Mining South Africa v Marsden supra* the court at para 71 held that even where a party sought to litigate on the business rescue plan, it would have to convince the court that exceptional circumstances for doing so exist. This approach has been overturned by the same division in *Moodley v On Digital Media (Pty) Ltd and Others* (20456/2014) [2014] ZAGPJHC 137; 2014 (6) SA 279 (GJ) (11 July 2014) and in the recent *Arendse and Others* case *infra*. See *Merchant West case supra* where the court made reference to the need for a 'well-motivated application...' for leave.

¹⁹⁰ *Moodley supra* at para 10.

¹⁹¹ This was cited with approval in *Hlumisa Investment Holdings (RF) Limited and another v Van der Merwe NO and others* [2016] JOL 34326 (GP) where the court held that proceedings in that matter were aimed at the Business Rescue Practitioners and not at the company under business rescue. For this reason, the court opined that neither consent nor leave of the court, as contemplated in section 133, was necessary.

The consequence of the judgment is that a party does not require leave from court in an application seeking guidance on the manner in which an adopted plan has been executed by the practitioner.¹⁹² An aspect which has not received clear articulation in the Companies Act and which does not seem to have been given much attention by courts is whether it is sufficient for an applicant seeking leave to institute legal proceedings to incorporate this as a prayer in the main proceedings or must such applicant initiate a substantive, separate application seeking leave.

In *Safari Thatching Lowveld*¹⁹³ the court had to adjudicate an application for business rescue in terms of section 131, while an earlier application for the winding up of the Respondent remained pending. The court agreed that the effect of the application for business rescue was to notionally suspend the liquidation application.¹⁹⁴ In an *obiter* remark, the court provided a brief discussion on the application of section 133, as the intervening party was found to have placed strong reliance on this section in seeking to halt the winding-up.

Providing a brief canvass of the case-law in point¹⁹⁵, the court distinguished between an application for relief where legal proceedings had already commenced and predated the application for business rescue versus an application to institute legal proceedings while rescue proceedings were in commencement.¹⁹⁶ The court concluded that where an application for business rescue was made while legal proceedings against the debtor were in commencement, a litigant already engaged in litigation with the debtor could request leave in terms of section 133 during those same proceedings in order to proceed with the pre-existing legal process.¹⁹⁷ In *Elias Mechanicos*¹⁹⁸ the court came to a different conclusion, finding that a separate application needed to be launched and did not draw a distinction between pre-existing

¹⁹² The court's rejection of the requirement of 'exceptional circumstances' has been cited with approval in the subsequent *Resource Washing (Pty) Ltd supra* at para 10.

¹⁹³ *Safari Thatching Lowveld CC v Misty Mountain Trading 2 (Pty) Ltd (Jeroldi Intervening, Brink Intervening)* (52115/2015) [2015] ZAGPPHC 832 (11 December 2015).

¹⁹⁴ *Safari Thatching Lowveld CC supra* at para 4.6.

¹⁹⁵ Specifically on the question whether an applicant has to institute separate legal proceedings for the purpose of lifting the stay or whether such requirement would suffice as a prayer in the main proceedings.

¹⁹⁶ This in the court's view distinguished the case from *Elias Mechanicos Building and Civil Engineering Contractors (Pty) Ltd v Stedone Developments (Pty) Ltd and Others* 2015(4) SA 485 (KZD). In this case the court found that a separate application for leave to institute legal proceedings against the debtor would have to be made. It is to be highlighted that the case dealt specifically with section 133 while *Safari Thatching Lowveld CC supra* dealt primarily with section 131. Compare with the *Kariba Manufacturers* case at court *a quo supra*.

¹⁹⁷ *Safari Thatching Lowveld CC supra* at paras 4.13- 4.14.

¹⁹⁸ At para 11-13.

or legal proceedings instituted subsequent to commencement.¹⁹⁹ Clearly, our courts are not *ad idem* on this aspect.²⁰⁰

In addition, a matter that remained largely uncertain until recently has been the test applicable to the granting of leave to institute legal proceedings. This aspect has received the attention of the court in the *Arendse*²⁰¹ matter. Observing that no particular test has been devised in previous matters²⁰², the court pertinently set out the ambit of the moratorium as follows:

But the moratorium is not an absolute bar to legal proceedings being instituted or continued against a company under business rescue. It is intended to be of a temporary nature only and cannot be utilised to indefinitely delay satisfaction of the claims of creditors; or result in the extinguishment of the claims of creditors...²⁰³

It was held that an applicant seeking leave to institute legal proceedings against a debtor would have to establish a *prima facie* case against the latter.²⁰⁴ In determining whether this requirement has been satisfied the court will have regard to evidence presented by the applicant as a whole, without recourse to evidence presented by the respondent in rebuttal.²⁰⁵ The court observed that at this stage it would not be critical to show that the application would, of necessity, succeed.²⁰⁶ The

¹⁹⁹ It is not clear that this aspect formed the ratio of the judgment; see para 14. This is to be contrasted with the approach in *Kariba Manufacturers* where the court *a quo* accepted without discussion that such application could form part of the main application. The decision in *Elias Mechanicos supra* seems consistent with the earlier *Msunduzi Municipality v Uphill Trading 14 (Pty) Ltd and Others* (11553/2012) [2014] ZAKZPHC 64 (27 June 2014) where the court, adjudicating on the second and third respondent's reliance on section 133, held at para 8 that leave of the court was required prior to any legal proceeding or enforcement action being commenced against a company in business rescue. In the view of the court, this meant that the leave sought could not simply be requested from the bar but had to be substantive and on affidavits, providing the company in business rescue with a proper opportunity to oppose it.

²⁰⁰ In the recent *Booyesen v Jonkheer Boerewynmakery (Pty) Ltd and Another* (10999/16) [2016] ZAWCHC 192 (15 December 2016) matter the court has adopted a dissenting position to both the *Moodley* and *Elias Mechanicos* cases *supra*. At paras 54-57 the court held that it would be wrong to create a hard and fast rule in relation to the question whether or not a formal or separate application for leave was must requested by an applicant in terms of section 133. Concluding that the facts and circumstances of the matter would be determinative, it was held that where judicial discretion is to be exercised, such discretion must to be informed by convenience, fairness and the interests of justice. Therefore, the court opined, there would be instances where a separate court application requesting leave in terms of section 133 would be necessary. There would further be instances where such request can be made as a prayer on the same papers as the main application.

²⁰¹ *Mabote and Others v Van Der Merwe NO and Another* (2015/40324) [2016] ZAGPJHC 185 (8 July 2016).

²⁰² See *Merchant West and Redpath Mining* cases *supra*. The court expressly rejected the approach in *Redpath Mining*.

²⁰³ *Arendse and Others supra* at para 15; *Kythera Court v Le Rendez-Vous Cafe CC and Another* (2016/11853) [2016] ZAGPJHC 172; 2016 (6) SA 63 (GJ) of 22 June 2016 at para 8.

²⁰⁴ *Arendse and Others supra* at para 16.

²⁰⁵ *Arendse and Others supra* at para 18. At para 19 the court observed that where there are real and fundamental disputes between the parties, a *prima facie* case would have been established.

²⁰⁶ *Arendse and Others supra* at paras 22-23.

court considered it to be sufficient if the applicant is able to demonstrate a cause of action (whether or not this is capable of being contradicted by the respondent).²⁰⁷

Despite having adopted a lower threshold for establishing a *prima facie* case within the context of section 133(1)(b), it was the court's view that an applicant would still be required to establish reasons why leave to proceed against the debtor in business rescue was, *inter alia*, both necessary and appropriate.²⁰⁸

The Act imposes a moratorium on the disposal of property interests. During business rescue proceedings, the company may only dispose of its property in three instances: (i) where this is in the ordinary course of the company's business, (ii) where a *bona fide* transaction has been entered into by the company and a 3rd party for fair value provided that prior approval has been granted by the practitioner or (iii) in a transaction that has been contemplated as part of the business rescue plan.²⁰⁹

For the moratorium to come to effect, property potentially subject to it must be either owned by the company or in its lawful possession.²¹⁰ The moratorium on property interests is so extensive that it is capable of imposing a restriction on property rights which a 3rd party has in respect of property in the company's possession even if the 3rd party is the owner.²¹¹

'Property' does not extend to a credit facility in favour of the company or to property being rented by the company.²¹² Where property is owned by a third party, it is a requirement that the company relying on the moratorium be *in lawful possession*

²⁰⁷ *Arendse and Others supra* at para 27.

²⁰⁸ *Arendse and Others supra* at para 28. The court further re-iterated that the statutory discretion granted to courts in section 133 is wide and not subject to a closed list of factors. It provided guiding principles which would have to be considered when such leave is sought. These factors attempt to strike a balance between the rights of affected persons as against the debtor, the effect of recourse against the debtor's chances of financial recovery and such recourse's effect on the rights and interests of the debtor's stakeholders as a whole. The approach in *Arendse* has received the support of the court in the recent *Metboard Properties Limited v At Andrea Packaging (Pty) Ltd and Another* (High Court of South Africa, Western Cape Division- Cape Town) case no. 12585/2016 of 12 September 2016 at 6-10.

²⁰⁹ Companies Act of 2008, section 134(1)(a).

²¹⁰ Section 133(1); See the *dictum* of the court in *Madodza supra* at paras 16 and 17. See further *178 Stamfordhill CC v Velvet Star Entertainment CC* (1506/15) [2015] ZAKZDHC 34 (1 April 2015).

²¹¹ Companies Act of 2008, section 134(1)(c). Although extensive, it is not without limitation. See section 134(3)(a)(b) read with 136(2A)(c); see further *Merchant West Working Capital Solutions (Pty) supra* at para 17.

²¹² See generally *Cloete Murray NO and another v FirstRand Bank Ltd* [2015] ZASCA 39 (26 March 2015).

in order to shield the debtor-company from that party's vindictory claim.²¹³ The practitioner may consent or withhold consent in relation to the disposal or release of property.²¹⁴ The consent extends to a third party's ability to cancel a contract and repossess its property.²¹⁵

The suspension of actions or claims against the company excludes criminal proceedings, set-off rights against a claim made by the company in legal proceedings or proceedings concerning property or a right over which the company is a trustee.²¹⁶ The phrase 'legal proceedings' is to be interpreted in terms of its ordinary meaning and has been found to intimate a 'lawsuit', 'hoofsaak' or 'geregtelike stappe, insluitende afdwingingsaksie'.²¹⁷ The Supreme Court of Appeal in *Cloete Murray NO*²¹⁸ articulated its view on the terms 'legal proceedings' and 'enforcement action' thus:

...in our legal parlance, 'enforce' or 'enforcement', usually refers to the enforcement of obligations. In the context of s133(1) of the Act, it is significant that reference is made to 'no legal proceedings, including enforcement action'. The inclusion of the term 'enforcement action'

²¹³ My emphasis. See *Madzodza supra* case at paras 16-17. See further the *obiter* remarks of the court in *Lifman and Others v The Commissioner, SARS and Others* (Western Cape High Court) case no. 5961/15 of 17 June 2015 at para 35 where it was held that section 133 does not have retrospective application for steps taken prior to the filing of rescue proceedings. The court in *Southern Value Consortium v Tresso Trading 102 (Pty) Ltd and Another* (16139/2015) [2015] ZAWCHC 174 (23 November 2015) further expanded the requirement of lawful possession to the application of section 134(1)(c). See *Kythera Court v Le Rendez-vous Café CC t/a Newscape Bedfordview and Another* matter at para 9. The court's interpretation of section 134 in the earlier *Tresso Trading 102* matter seems to have received the support of the court in the *Kythera Court* matter. On the content of the term 'lawful', see *JVJ Logistics (Pty) Ltd v Standard Bank of South Africa Ltd and others*[2016] JOL 36313 (KZD).

²¹⁴ In *2001 Management Services (Pty) Limited and Another v Anappa* (88079/14) [2016] ZAGPPHC 353 (20 May 2016) the court at para 37 affirmed its authority to entertain an application to consider lifting the moratorium in the absence of practitioner consent. It further held that in exercising its discretion, the *bona fides* of the initiator of business rescue proceedings would be a relevant factor.

²¹⁵ *Cloete Murray supra* at para 35. It remains to be seen whether a practitioner will be able to suspend a bank's right to renounce access to a credit facility, even if such act is accepted as not constituting an enforcement step on the part of the bank as has been held by the courts. It will be interesting to observe the development of the ambit of section 136. A party to such cancelled agreement would be entitled to damages only, see section 136(3). See however the *obiter* remarks of the court in *Homez Trailers And Bodies (Pty) Ltd supra* at para 25 where the court held that only the obligations of the company are susceptible to being cancelled by the practitioner. However, see *obiter* remark in the recent *Kythera Court v Le Rendez-vous Café CC t/a Newscape Bedfordview and Another supra* at paras 15 and 16 and 30 where the court, citing the *Cloete Murray* matter, accepted that it would be possible for the practitioner to invoke section 136(2)(a) and suspend a counterparty's right to cancel an agreement (i.e. a lease in that matter). It would seem that the courts have at this stage largely sought to distinguish between contractual obligations affecting third parties (such as credit agreements) and physical property belonging to a third party within the company's possession during business rescue proceedings (such as goods sold on instalment).

²¹⁶ Companies Act 71 of 2008, section 133(1).

²¹⁷ *Merchant West Working Capital supra*; *Van Zyl v Euodia Trust (Edms) Bok* 1983 (3) SA 394 (T) at 397; *Lister Garment Corporation (Pty) Ltd v Wallace NO* 1992(2) SA 722 (D) at 723 G-H]; *Cloete Murray NO and another supra*.

²¹⁸ *Cloete Murray supra*.

under the generic phrase ‘legal proceeding’ seems to me to indicate that ‘enforcement action’ is considered to be a species of ‘legal proceedings’...²¹⁹

The court further observed:

A ‘forum’ is normally defined as a court or tribunal...and its employment in s 133(1) conveys the notion that ‘enforcement’ relates to formal proceedings ancillary to legal proceedings, such as the enforcement or execution of court orders by means writs of execution or attachment.²²⁰

The court found that the cancellation of a credit agreement was not prohibited by the application of the moratorium.²²¹ Agreeing with the observations made in *Henochsberg*, to the effect that the moratorium is meant to be cast as widely as possible so as to provide the company with much needed protection against creditor claims, the court disagreed that the manner argued for by the appellants would be the best way of achieving this.²²²

The Supreme Court of Appeal²²³ has in a recent matter extended the application of the moratorium to include arbitration proceedings.²²⁴

It further concluded:

In my view once this purpose of business rescue- to give the practitioner breathing space- is properly understood, it becomes apparent that only an interpretation that includes arbitrations within, instead of excluding them from, the meaning of legal proceedings in s 133(1), allows this provision to be read harmoniously with s 142(3)(b)...There can be no reason why s 142(3)(b) obliges the company to provide details of arbitrations to the practitioner other than because they are also legal proceedings- as contemplated in section 133(1)- that may have a bearing on its financial viability and of which the business rescue practitioner must be cognisant.²²⁵

²¹⁹ *Cloete Murray supra* at para 32; See *Cawood NO and others v Reaan Swanepoel t/a Reaan Swanepoel Attorneys and Others* [2015] JOL 34283 (GP) where the court interpreted ‘execution’ as a process rather than a single event.

²²⁰ *Cloete Murray supra* at para 32.

²²¹ *Cloete Murray supra* at para 33.

²²² *Cloete Murray supra* at para 34-5.

²²³ *Chetty v Hart* (20323/2014) [2015] ZASCA 112; 2015 (6) SA 424 (SCA); [2015] 4 All SA 401 (SCA) (4 September 2015).

²²⁴ *Chetty v Hart supra* at para 28. In relation to arbitration proceedings in terms of the Labour Relations Act of 1995 (LRA) see *obiter* remarks of Lagrange J in *NUMSA obo Members v Motheo Steel Engineering* (Labour Court of South Africa) case no. J 271/2014 of 7 February 2014 and the subsequent Bargaining Council jurisdictional ruling METS 3334 ruling delivered on 5 May 2014. However, see the earlier conflicting decision on this point in *Fabrizio Burda v Integcomm (Pty) Ltd* case no. JS539/12 (unreported) of 29 November 2013, where the Labour Court held that section 133 had the effect of barring employment related disputes which were referred to the CCMA or the Labour Court. In the recent *Sondamase and Another v Ellerrine Holdings Limited (in business rescue) and Another* (Labour Court) unreported case no. C669/12 of 22 April 2016, the Labour court declined to follow the approach in *Moteo Steel*. Observing that the purpose of business rescue was to provide breathing space, it referred to the approach in *Integcomm* with approval and held that the SCA in *Chetty v Hart* had dealt with the issue of conflicting case law within the context of section 133 and arbitration proceedings. In the even more recent case of *Ellerrine Furnishers (Pty) Ltd and Others v FGWU obo Cleopatra Somtsewu* (Labour Court) unreported case no. JR 1836/15 of 26 April 2016 the Labour Court followed the *Sondamase* decision. It will be interesting to observe how the moratorium is applied within the context of employee arbitrations in future where regard is had to section 210 of the LRA as well as section 5 of the Companies Act of 2008.

²²⁵ *Chetty v Hart supra* at para 29.

The moratorium is critical for the success of any business rescue. It may be argued that the courts, apart from disagreeing on certain aspects, have recognised the importance of this mechanism in interpreting its ambit. It is also to be observed that the courts have attempted to provide some protection for creditors in widening the ambit of concepts such as the requirement of lawful possession, the non-retrospective application of the moratorium and a 3rd party's right to cancel credit agreements.

4.6. POST-COMMENCEMENT FINANCING

Securing post-commencement finance is an important aspect in developing and implementing a successful plan to rescue the company.²²⁶ It is, however, expected that lenders will be hesitant to borrow money to a company that may be perceived as having 'shown' itself as unable to manage its financial affairs.²²⁷ In addition, a financially distressed company may not have sufficient unencumbered assets to offer as security in order to obtain a much-needed cash injection.

It has been argued that post-commencement finance will present itself in two phases, namely to provide the necessary funds for the operational functioning of the company until the stage where the plan has received approval from creditors, as well as after plan adoption and during the implementation stage.²²⁸ In a manner similar to the super-priority provided for in § 364 of the Bankruptcy Code²²⁹, Chapter 6 creates a statutory framework providing a super-priority for financing granted after commencement of rescue proceedings.²³⁰

The provision regulating post-commencement finance reads:

- 135(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee—
- (a) the money is regarded to be post-commencement financing; and
 - (b) will be paid in the order of preference set out in subsection (3)(a) .
- (2) During its business rescue proceedings, the company may obtain financing other than as contemplated is subsection (1), and any such financing—
- (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
 - (b) will be paid in the order of preference set out in subsection (3)(b) .

²²⁶ For a comprehensive analysis of this aspect as well as the practical implications thereof, see Wanya du Preez 'The status of post-commencement finance for business rescue in South Africa' (MBA Thesis, Gordon Institute of Business Science, 2012).

²²⁷ Similar observations are made by Pretorius, M. and Du Preeze, W. 'Constraints on decision making regarding post-commencement finance in business rescue' (2013) Volume 6 *Southern African Journal of Entrepreneurship and Small Business Management* 168 at 170. See further Marius Pretorius 'Business Rescue Plans' (2012) (Unpublished Research).

²²⁸ David A. Burdette 'Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 2)' (2004) 16 *South African Mercantile Law Journal* at 422-423.

²²⁹ Discussed in Chapter 5.

²³⁰ Referred to as 'post-commencement financing'.

- (3) After payment of the practitioner's remuneration and costs referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated—
 - (a) in subsection (1) will be treated equally, but will have preference over—
 - (i) all claims contemplated in subsection (2), irrespective whether or not they are secured; and
 - (ii) all unsecured claims against the company; or
 - (b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.
- (4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.

If the company has unencumbered assets it may apply these in order to secure additional financing once proceedings have commenced.²³¹ On an ordinary grammatical interpretation of the section, finance provided after commencement is preferent to any unsecured claim against the company. Cassim observes that due to the word 'finance' not having been defined in the Act, it remains unclear as to how widely the term is to be interpreted.²³² Further, it has been argued that the terms 'employment-related payments' or 'money relating to employment' are wider than the terms 'wages' or 'salary' which would mean that redundancy payments, although not wages or salary, could fall within the ambit of the section and enjoy the preference accorded by section 135.²³³

An aspect inextricably linked to the priority created in the above provision is the ranking of creditor claims. This is because through its provisions, the 2008 Act invariably determines the rank and manner in which creditors are to be paid. It further sets the schematic context for the post-commencement treatment of claims as against pre-commencement liability during business rescue. The ranking of creditor claims is discussed next.

4.7. THE RANKING OF CLAIMS

With a moratorium on all claims against the company taking effect, the question arises as to whom to pay first, together with the question of how to restructure. The courts have provided some guidance on both ranking of creditor claims as well as post-commencement financing. Although not strictly relevant to the issue it was asked to decide, the court in *Redpath Mining* articulated the ranking of creditor claims in the following manner:

Claims rank in the following order of preference:

²³¹ Companies Act 71 of 2008, section 135(2).

²³² Cassim (2012) at 883.

²³³ Cassim (2012) at 884.

- 60.1 The practitioner, for remuneration and expenses, and other persons (including legal and other professionals) for costs of business rescue proceedings.
- 60.2 Employees for any remuneration which became due and payable after business rescue proceedings began.
- 60.3 Secured lenders and other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.
- 60.4 Unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post commencement finance.
- 60.5 Secured lenders or other creditors for any loan or supply made before business rescue proceedings began.
- 60.6 Employees for any remuneration which became due and payable before business rescue proceedings began.
- 60.7 Unsecured lenders or other creditors for any loan or supply made before the business rescue proceedings began...²³⁴

It may be argued that this form of ranking is not reflective of the ordinary, grammatical language employed in section 135.²³⁵ One of the significant differences between the ranking of claims by the court in the *Merchant West case* and section 135(2) is that apart from monies referred to in sub-section 1, the section does not seem to distinguish between secured and unsecured post-commencement financing claims. Its focus is rather on the timing of the financing obtained.²³⁶

Commenting on the judgment of the court, *Meskin et al* observe as follows:

[The ranking of the court in *Merchant West*] does not seem to be in accordance with the provisions of sub[-section] 3, *inter alia* because the subsection does not refer to secured claims “before business rescue began” as these are regulated by s[ection] 134...²³⁷

The court further confirmed that the ranking is crystallised by section 135(4) where proceedings are followed by liquidation:

Section 135(4) of the Act provides that if business rescue proceedings are superseded by a liquidation order, the above preference will remain in force except to the extent of any claims arising out of the costs of that liquidation.²³⁸

A potential confusion may arise when the provisions of section 135(2) are analysed. Sub-section 2 states that in obtaining post-commencement finance, the company may use an asset as security in favour of the lender for the granting of post-commencement financing ‘to the extent that it is not otherwise encumbered’. The section therefore provides protection for assets which were already encumbered prior to commencement of proceedings.²³⁹

²³⁴ *Redpath Mining South Africa supra* at para 60. See also paras 20-23 of the earlier *Merchant West Working Capital case*.

²³⁵ Companies Act 71 of 2008 discussed above.

²³⁶ It may be argued that the Act possibly envisaged a ‘first come first serve’ basis for ranking post-commencement creditor claims, whether or not such post-commencement financing was secured. It would seem at least at this stage, that the position has been changed by the court in the *Redpath Mining case supra*.

²³⁷ *Henocheberg on the Companies Act of 2008* at 478.

²³⁸ *Redpath supra* at para 61.

²³⁹ See *Henocheberg on the Companies Act of 2008* at 478.

The provisions of section 135(2) and ranking of creditor claims by the court in the *Redpath* and *Merchant West* cases are to be analysed in light of the protection of property interests clause which, despite granting the company authority to dispose of its assets in certain circumstances, places the following constraints:

- (3) If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has *any security or title interest*, the company *must*—
 - (a) obtain the prior consent of that other person, *unless* the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest; and
 - (b) *promptly*—
 - (i) pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person; *or*
 - (ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.²⁴⁰

The company may not, without prior consent from a security or interest holder, encumber an asset already secured at the pre-commencement stage.²⁴¹ As an exception, encumbrance may occur provided that the security interest or title-holder is promptly reimbursed for the value of his/her title interest in full.²⁴² On a reading of the relevant sections, the ranking of creditor claims articulated in the above judgments is not reflective of an ordinary grammatical interpretation of the Act. A pre-commencement secured creditor ought to be entitled to receive the value of its security as against the borrower company in preference to both secured and unsecured post-commencement finance creditors.²⁴³

The court in *Redpath* further articulated the status of secured creditors during proceedings as follows:

It is my further view and finding that in a business rescue atmosphere secured creditors stand on the same footing during its subsistence as the other creditors. The common purpose and desire and objective is that each creditor ultimately get every cent he/she is owed, unlike in a liquidation or its predecessor, the judicial management system. Should the rescue plan run into difficulties and

²⁴⁰ My emphasis. At section 134(3).

²⁴¹ Even within the context of securing post-commencement finance.

²⁴² This may include an interest secured by a cession of book debts. A debtor company may not cede its debtors book to a creditor and upon commencement of business rescue, wish to collect on debtors to the prejudice of the cessionary's rights in terms of section 134(3); see *Kritzinger and Another v Standard Bank of South Africa supra* at paras 49 and 51; *Gormley supra* at para 18.

²⁴³ See *Senwes Limited v Zellenhen Boerdery CC and Others; Zellehen Boerdery CC v Senwes Ltd infra* where the court, adjudicating on an application for an order that a creditor's vote against the plan was inappropriate, held that nothing in section 134(3) compelled a creditor to surrender its pre-existing security. Even though the court did not discuss the earlier *Redpath Mining* case, implicit in the judgment is a rejection of the ranking articulated in *Redpath*. In this regard, the court at para 31 further observed:

'In my view, the legislature did not intend section 143(5) to override 134(3) of the Act, otherwise section 134(3) which affords protection to a secured creditor, would be rendered nugatory. It could never have been the intention of the legislature to frustra[te] a secured creditor by ensnaring the secured creditor in a long business rescue process coupled with the uncertainty and speculation as to whether or not the secured creditor is ultimately going to be paid. If the secured creditor is not prepared to indulge itself in such a risk it can surely not be said that its vote against such an uncertain risky plan is an inappropriate vote...'

the liquidation of assets become necessary, section 134(3) serves as a safeguard and assurance that the interests of secured creditors especially, are protected.²⁴⁴

It is not clear to which secured creditor the court is referring.²⁴⁵ It is also not entirely clear what the court means when it is observed that ‘secured creditors stand on the same footing as other creditors’ as the section considered by the court clearly envisages a preference in ranking between creditors’ claims.

The interpretation of section 135 in the *Redpath* and *Merchant West* cases seems to provide cold comfort for the pre-commencement secured creditor. It has essentially left the pre-commencement secured creditor potentially in a weaker position; where the strength of protection afforded by a notarial or mortgage bond over the defaulting company as a strong form of security may potentially become diluted.²⁴⁶

The distinction in ranking drawn may potentially create challenges of its own. A possible practical consequence may be in the form of banks consistently opposing business rescues or deliberately applying for liquidation. Even though safeguards

²⁴⁴ *Redpath* at para 66.

²⁴⁵ Specifically, whether the court is referring to the pre or post-commencement secured creditor.

²⁴⁶ It is acknowledged that this could also potentially be applicable to employee creditors in relation to pre-commencement remuneration payments. A significant difference between this creditor and an ordinary pre-commencement supplier creditor is that employees, where retrenched, will have the legal benefits accruing in terms the Labour Relations Act in relation to retrenchment payments. This aspect is canvassed in Chapter 3. Where employees are retained by the company after commencement, their salary and remuneration payments have the status of super preferent post-commencement financing as discussed above. This is a simple example of how protections granted to these two classes of creditors are significantly incongruent.

have been put in place by courts in evaluating reasonableness of liquidation applications, the manner in which section 135 has been drafted does not assist.²⁴⁷

A further consequence of the judgments²⁴⁸ is that the pre-commencement secured creditor, who in the past could ordinarily resort to liquidation as a safety net, may find itself in a disadvantaged position. Section 135(4) ‘freezes’ the ranking stipulated in section 135(3).²⁴⁹ This means that in a subsequent liquidation, the pre-commencement secured creditor may find itself ranking after costs of liquidation, costs of the failed business rescue (including practitioner fees)²⁵⁰, employee related payments after commencement and post-commencement finance advanced during proceedings (whether secured or unsecured).²⁵¹

4.8. CRYSTALLISED RANKING AND THE UNDELIMITED GROUND

Due to existing gaps in the Act²⁵², the ‘freezing of ranking’ in section 135 (4) may in certain instances be practically ineffective. The premise, on which the section is based, is that if a plan is neither adopted nor successful, proceedings will ultimately

²⁴⁷ See *Nedbank Ltd v Bestvest 153 (Pty) Ltd*; *Essa v Bestvest 153 (Pty) Ltd* 2012 (5) SA 497 (WCC). In the *Oakdene Square Properties* case the Supreme Court of Appeal, evaluating the reasonableness of a creditor’s desire to oppose a business rescue plan, held at para 38 as follows:

‘As I see it, the applicant for business rescue is bound to establish reasonable grounds for the prospect of rescuing the company. If the majority creditors declare that they will oppose any business rescue scheme based on those grounds, I see no reason why that proclaimed opposition should be ignored. Unless, of course, that attitude can be said to be unreasonable or *mala fide*... Moreover, the Court is unlikely to interfere with the creditors’ decision unless their attitude was unreasonable’

See *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another* (365/2014) [2014] ZAGPPHC 688; 2014 (6) SA 214 (LP) (9 May 2014) where the court described the conduct of one creditor in rejecting a business rescue plan as ‘self-serving and, with respect, unreasonable’. The approach in *Copper Sunset* was however rejected by the court in the later *Shoprite Checkers (Pty) Limited v Berryplum Retailers CC and Others* (47327/2014) [2015] ZAGPPHC 255 (11 March 2015) case. However see *Ex parte: Target Shelf 284 CC*; *Commissioner, South African Revenue Service and Another v Cawood N.O. and Others* (21955/14; 34775/14) [2015] ZAGPPHC 740 (13 October 2015). At paras 32 & 33 the court endorsed the tests devised in *Shoprite* but disagreed with the manner in which they were to be applied. Declaring the vote of a dissenting creditor to have been inappropriate, the court in *KJ Foods CC v First National Bank* (75627/2013) [2015] ZAGPPHC 221 (23 April 2015) at para 10 placed emphasis on a balancing of interests in favour of the protection of employee interests, where it was shown that in doing so, the interests of other creditors would not be adversely affected. This approach has been rejected in the recent *Senwes Limited v Zellenhen Boerdery CC and Others*; *Zellehen Boerdery CC v Senwes Ltd* *infra* matter at para 32; See *Zoneska Investments (Pty) Ltd/ Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd* Case no 9831/2011; 7811/2012 [2012] ZAWCHC 163 (28 August 2012) at para 67. See further *Spitskop supra* at para 47, where the court held that it would ignore an intervening creditor’s (in this case SARS) view where it was unreasonable or *mala fide*.

²⁴⁸ If the judgements are accepted as reflective of the correct legal position.

²⁴⁹ This position has been confirmed by the court in *Merchant West* at para 61.

²⁵⁰ The court in *Diener NO v Minister of Justice* 2016 JDR 0632 (GP) of 2 March 2016 at paras 56- 60 dealt with the ranking of practitioner remuneration where a company in business rescue was subsequently liquidated, with practitioner fees not having been paid during rescue.

²⁵¹ See further the omnious observations made by Meskin *et al* at 478.

²⁵² Companies Act 71 of 2008.

convert to liquidation.²⁵³ The different legal bases in which rescue proceedings may be terminated are relevant in the context of critiquing this aspect.

The Act allows for termination²⁵⁴ of proceedings where a notice of substantial implementation has been filed²⁵⁵; where the company is not financially distressed²⁵⁶ or where there is a ‘deadlock’ in respect of voting on a plan²⁵⁷. The Act further allows for an essentially ‘undelimited’ ground on which proceedings may be terminated.²⁵⁸ The question that must be answered is; on what basis may a practitioner terminate proceedings on the latter basis? The question is relevant because permissive provisions, which are open ended, often create fertile ground for abuse.

The consequence of a ‘simple’ termination of proceedings (as opposed to a substantial implementation or a termination coupled with liquidation) is that it allows creditors to pursue their claims against the company without having to concern themselves with a moratorium that is in place. At termination, the veil of the moratorium ‘falls away’.²⁵⁹ Therefore where proceedings are terminated on the ‘undelimited ground’ in section 132(2)(b)²⁶⁰, the immediate consequence is that a creditor may enforce its claim against the company and whichever creditor is ‘first in law’, has the benefit of enforcing its claim.²⁶¹ I submit that protections for post-commencement financing creditors in section 135(4) find practical application where the company is subsequently liquidated and not where proceedings have simply been terminated.

Practically and where the company is not subsequently liquidated, creditors ranked in terms of section 135 are not in a particularly strong position as against ordinary concurrent creditors.²⁶² The same situation prevails where proceedings have terminated without a plan having been adopted. Where proceedings have terminated

²⁵³ In terms of section 141(2)(a), where there is no reasonable prospect for the company to be rescued.

²⁵⁴ Without necessarily having to convert business rescue to liquidation.

²⁵⁵ Companies Act of 2008, section 132(2)(c)(ii).

²⁵⁶ Companies Act of 2008, section 141(2)(b).

²⁵⁷ Companies Act of 2008, section 153(5). See *The Commissioner of the South African Revenue Services (Intervening) In re: Primrose Gold Mines (Pty) Ltd* (High Court of South Africa Gauteng Division) case no. 56581/2014 of 12 September 2014.

²⁵⁸ Companies Act of 2008, section 132(2)(b). Even if one were to argue that such ground is not undelimited, the Act does not clearly state the specific grounds on which the section may be invoked.

²⁵⁹ A termination on the basis of a ‘deadlock’ in terms of section 153(5) presupposes that the plan could not be adopted and therefore any proposed plan has no force or effect.

²⁶⁰ The interpretation of this section by the courts is discussed below.

²⁶¹ Assuming that monies or assets available to the company are sufficient to cover the said claim. Levenstein in his thesis at 369- 371 seems to hold the view that this provision applies in instances where the practitioner concludes that there are no longer reasonable grounds to believe that the company is financially distressed.

²⁶² Unless if they have some form of security over the assets of the company.

with a plan having been validly adopted, different consequences may follow depending on the conditions existing in the adopted plan.²⁶³

The law largely remains unclear but some guidance has been provided by the court in *Primrose*. In this matter the second and third applicants were appointed as business rescue practitioners on 3 June 2013. Having presented a proposed plan for creditor approval after a number of months, it was found to be unacceptable by the company's creditors and rejected on this basis. None of the affected parties took further action as contemplated in section 153 resulting in a lapsing of time periods in terms of the Act. The practitioners proceeded to file for termination of business rescue. The notice of termination was rejected by CIPC. The practitioners sought a declaratory order, which was granted by the court on the 30 May 2014.

The issue that the court in *Primrose* was to decide was whether, in filing a notice of termination as contemplated in section 153 and in terms of the declaratory order granted on the 30 May 2014, the practitioners had validly terminated proceedings and thus had no *locus standi* in the current proceedings to liquidate Primrose.

Articulating the interplay between the provisions of section 132 and section 141 of the Companies Act²⁶⁴, the court observed:

There is a reason why the court ordered that s 132(2)(a)(ii) be read together with s 141 of the Act. This is simply because s 132(2)(a)(ii) cannot come into being before section 141, in particular subsection (2)(a)(ii) thereof has been complied with... When business rescue proceedings come to an end, either the court shall have converted the rescue proceeding to liquidation proceedings or the practitioner shall have filed a notice of termination of the business rescue process.²⁶⁵

Developing the point, the court further noted:

In order to reach the finality contemplated in s 132(a) and (b) of the Act, the practitioner must either apply for the discontinuance of proceedings or file a notice of termination... The business rescue practitioner is enjoined in terms of s 141(2)(a)(ii) of the Act to apply for the discontinuance of the business rescue proceedings or by 141(2)(b)(ii) of the Act to file a notice of termination in order for the business rescue process to end. The action taken by the business rescue practitioner in terms of s141(2)(a)(ii) of the Act will result in the 'state of affairs' in s 132(2)(a)(ii) of the Act;

²⁶³ There is, however, a significant amount of uncertainty in this area. For example, what would the status be where there had been a validly adopted plan in the absence of a default/cancellation clause? Would the provisions of the plan as adopted by creditors still find application even if such plan fails but only in part? Would creditors only be entitled to collect the compromised portion of their claims or the full portion (see section 154) or would they have to approach the courts for an order declaring the plan, which is essentially a contract, to have terminated and the failure to implement in full to constitute a material breach?

²⁶⁴ Companies Act 71 of 2008.

²⁶⁵ *Primrose* at para 18.

and the action taken in terms of s141(2)(b)(ii) of the Act will culminate in the 'state of affairs' in s 132(2)(b) of the Act.²⁶⁶

The court may have settled some of the concerns raised earlier. Where proceedings are to be terminated while the company remains in financial distress, such termination should be accompanied by a liquidation application in order for it to be valid.²⁶⁷ In the absence of above procedure, the purported termination is invalid.²⁶⁸

Where, for example, a company terminates proceedings in terms of section 132(2)(b) due to there not being sufficient funds on the part of the company to pay the costs of liquidation, a potentially negative consequence may arise.²⁶⁹ In light of the *dictum* in *Primrose*, creditors of that company would be unable to enforce their claims due to a moratorium on claims against the company remaining in force. In addition, where a plan has been validly adopted it will not be possible for creditors to apply for the setting aside of the resolution solely on 'just and equitable' grounds in terms of section 130.²⁷⁰

On the facts of *Primrose*, recourse²⁷¹ was possible due to the proposed plan having been rejected by creditors.²⁷² The position has been complicated further by the recent judgment of the Eastern Cape Division in the *Landosec case*²⁷³. The facts

²⁶⁶ *Primrose* at para 18. See *Ex parte Target Shelf 284 CC; Commissioner, SARS and Another v Cawood and Others supra* at para 73 where the court has held that in addition to the practitioner, a creditor is entitled to make application for the conversion of business rescue to liquidation proceedings in terms of section 132(2)(a)(ii) where the provisions of section 132(2)(c)(i) find application; *Beer NO v Fozsa Logistics CC* (North Gauteng High Court) case no. 23039/2014 of 18 June 13 at para 16. In this matter the court expressed the view that ss 141 and 132 are to be read together.

²⁶⁷ *Primrose* at paras 18 & 20. Further reference to section 132(2)(b) & (c) is made by the Act within the context of section 81 relating to the winding up of solvent companies. The latter section is confusingly drafted. It is not clear why creditors (apart from non-independent creditors) would ask that a solvent company be wound up. If such company is indeed solvent (i.e. not 'financially distressed') it is difficult to see which circumstance would, in light of its solvency, result in (i) a business rescue plan being proposed to rescue a company that is solvent and, even more astonishingly, (ii) result in a situation contemplated in section 132(2)(c)(i). It is to be emphasised that it is a primary requirement that *inter alia* a company be 'financially distressed' before it can access Chapter 6 proceedings. For an analysis of the content of the term 'solvent company' in section 81 as well as a discussion into factual and commercial insolvency, see *Boschpoort Ondernemings (Pty) Ltd v ABSA Bank Limited* (936/12)[2013] ZASCA 173 (28 November 2013).

²⁶⁸ *Primrose* at paras 18-20.

²⁶⁹ I have observed this practice in industry in a number of business rescues.

²⁷⁰ See *Kariba supra* at para 59 and *DH Brothers supra* at para 53. This position has been confirmed by the Supreme Court of Appeal in *Panamo Properties supra*.

²⁷¹ For setting the resolution aside on the 'just and equitable' basis in section 130(5).

²⁷² It must be noted that an order sought in terms of section 130 has the consequence of terminating proceedings and does not result in an automatic liquidation. If a creditor desires that the company be liquidated, a firm foundation for this prayer must be made on the papers.

²⁷³ *Landosec (Pty) Ltd t/a Lasertech and Another v McLaren and Others* (Eastern Cape Division- Port Elizabeth) case no. 2231/2015 of 29 October 2015.

contained some similarities with the earlier *Primrose* case.²⁷⁴ Finding that section 141 of the Companies Act was irrelevant in the context of the matter, the court observed:

...The obligations placed upon a practitioner in terms of section 141 and 153 of the Act are meant to provide for two different scenarios. Section 141 envisages a situation where a practitioner has, after his or her appointment, investigated the company's affairs and concluded that there is no reasonable prospect for the company to be rescued, and thus would not have proposed a business rescue plan. Section 153 on the other hand spells out the obligations of a practitioner where a business rescue plan has been proposed and rejected. The provisions of section 141 of the Act are accordingly not of application in this case.²⁷⁵

The court found that the practitioner's appointment terminated once the notice in terms of section 153(5) was issued. This view implies that proceedings terminate at that stage without further action. Unfortunately the court does not seem to have made reference to persuasive authority of the earlier *Primrose* case on this point.

Responding to the contention that this view would essentially leave the company in limbo, the court responded:

I can also not agree with Mr Jooste's submission that a finding that the first respondent's appointment had terminated after the issue of the notice in terms of section 153(5), will have the effect of leaving the company in "limbo", to the detriment of the creditors. The fact of the matter is that the creditors themselves rejected the business rescue plan, and had been served with the aforesaid notice. It is therefore up to them to decide whether or not to exercise their remedies in terms of the common law or the Act.²⁷⁶

The approach in the earlier *Primrose* case is to be preferred. Apart from not having expounded on the interplay between sections 132(2) and the practitioner's duty in terms of section 153, the court seems to not have accounted for the fact that the duty to investigate the affairs of the company is a continuing one throughout the process (rather than being at a singular moment in time).²⁷⁷

Further developments have resulted in the *Primrose* judgment being overturned on Appeal.²⁷⁸ Rejecting the approach of the court *a quo*, the court of appeal found that section 132(2)(b) stated in general terms that proceedings end upon filing of a notice of termination with CIPC and that there was nothing specifically limiting this to a filing in terms of section 141(2)(b)(ii).²⁷⁹ In the view of the court, section 132(2)(b) was sufficiently broad to include filing of a termination in terms of

²⁷⁴ In that the court was primarily asked to decide the moment at which the practitioner ceased to exercise his/her powers as practitioner.

²⁷⁵ *Landosec supra* at para 10.

²⁷⁶ *Landosec supra* at para 12

²⁷⁷ The reader is referred to section 141(2)(a)(i) & (ii). Sub-section (2) specifically applies the phrase 'If, at any time during business rescue proceedings, the practitioner concludes that...' Where the conditional 'if' is found to be true, the sub-section stipulates actions that the practitioner must take.

²⁷⁸ *Commissioner for the South African Revenue Service v Primrose Gold Mines (Pty) Ltd and Others* (A932/14) [2016] ZAGPPHC 737 (23 August 2016). I refer this case as the '*Primrose* (Appeal)'.
²⁷⁹ *Primrose* (Appeal) at para 13.

sections 153(5) or 141(2)(b)(ii).²⁸⁰ On this basis, the court of Appeal found the approach of the court *a quo* to be both untenable and unduly restrictive.²⁸¹ A discussion into the treatment of employees as a specific class of creditor follows.

4.9. EMPLOYEE CREDITORS

The employee is a creditor in more than one sense. He/she is a creditor individually, where not part of an employee representative union²⁸² and a creditor in the collective sense where he/she is a member of a worker union.²⁸³ The employee is a preferent unsecured creditor in relation to liability for outstanding pre-commencement salaries.²⁸⁴

In addition, an employee may be a post-commencement financing creditor.²⁸⁵ These different legal positions result in different degrees of protection. Employees who were employed by the company continue to be employed on the same terms during business rescue proceedings.²⁸⁶ The Act makes it difficult for the practitioner to unilaterally retrench employees or suspend employment contracts. Such action is permissible only in specific circumstances and through an order of court. The relevant provisions²⁸⁷ provide as follows:

- (2A) When acting in terms of subsection (2)—
 - (a) a business rescue practitioner *must not* suspend any provisions of—
 - (i) any employment contract; or
 - (ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act 24 of 1936) would have applied had the company been liquidated...²⁸⁸

Limitations on the court's exercise of discretion are also outlined:

- (b) a court *may not* cancel any provision of—
 - (i) an employment contract, except as contemplated in subsection (1); or
 - (ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act 24 of 1936), would have applied had the company been liquidated...²⁸⁹

²⁸⁰ *Primrose* (Appeal) at para 13.

²⁸¹ *Primrose* (Appeal) at paras 14 & 15. Contrary to the view expressed by the court, it may surely be argued that the absence of an adopted plan may be a ground for holding a reasonable belief that the company (whilst still remaining in financial distress) does not have a reasonable prospect of rescue as contemplated in section 141(2)(a). Otherwise, how else will the company ensure that it receives buy in from its creditors and potential investors if the latter do not agree with the route proposed to relieve it of its financial burden?

²⁸² Companies Act 71 of 2005, Section 128(1)(a)(iii).

²⁸³ Companies Act 71 of 2005, Section 128(1)(a)(ii).

²⁸⁴ Companies Act 71 of 2005, Section 144(2).

²⁸⁵ Section 135(2) discussed above.

²⁸⁶ Section 136(1). An exception to this is where changes occur as a result of attrition or where an agreement, which is in accordance with the Labour Relations Act, is entered into between the company and its employees. See *Meskin et al* at 478(14).

²⁸⁷ See Companies Act 71 of 2008, section 136.

²⁸⁸ My emphasis. Companies Act 71 of 2008, section 136(2A)(a).

²⁸⁹ My emphasis. Companies Act 71 of 2008, section 136(2A)(b).

A court will be entitled to cancel a contract of employment on the ground of attrition or where employees and the company agree on different terms and conditions. In *Solidarity Obo BD Fourie & Others* the court remarked that the phrase ‘ordinary course of attrition’ in sub-section (1)(a) was irreconcilable with sub-section (1)(b) if it was interpreted as excluding all forms of lawful termination of employment which include retrenchment.²⁹⁰ Retrenchments resulting from cancellation will be subject to applicable provisions of the Labour Relations Act of 1995.²⁹¹

The Companies and Labour Relations Acts provide a framework through which employee contracts may either be terminated or amended.²⁹² The latter Act²⁹³ provides for the appointment of a facilitator, where requested by an employer²⁹⁴ or where requested by employee representatives in order to resolve a dispute relating to proposed dismissals.²⁹⁵ Where facilitation has failed to resolve the issue within a specific statutory time period, an employer may provide notice terminating employment contracts.²⁹⁶ Employees may respond by either giving a notice of strike or referring a dispute in relation to the procedural or substantive fairness of the dismissal to the Labour Court.²⁹⁷

To the extent that monies are owed to an employee’s medical, pension or provident scheme, the scheme ranks as an unsecured creditor.²⁹⁸ Any other benefits accruing to employees are incorporated by reference by sub-section 5.²⁹⁹

Section 144(3) provides employees, alternatively registered trade unions with participation rights throughout the business rescue process inclusive of notification of

²⁹⁰ *Solidarity Obo BD Fourie & Others v Vanchem Vanadium Products (Pty) Ltd and Others; In re: National Union of Metalworkers (NUMSA) Obo Members v Vanchem Vanadium Products (Pty) Ltd and Another* (J385/16 & J393/16) [2016] ZALCJHB 106 (22 March 2016) *obiter* at para 35 & 36. See earlier case *Clarke v EH Walton Packaging* [2014] JOL 31234 (CCMA judgment) where it was commented that, being in management-control, only the business rescue practitioner had authority to terminate the services of an employee once business rescue proceedings commenced. Accordingly, it was found that the purported termination of the employee was in breach of the Companies Act.

²⁹¹ Labour Relations Act 66 of 1995. It would seem that courts are endorsing the possibility of a practitioner being able to terminate contracts of employment prior to plan publication provided that this is done in a lawful manner (i.e. in compliance with the provisions of the Labour Relations Act). Such approach is welcome, especially in light of well-established protective mechanisms existing in our labour laws.

²⁹² Labour Relations Act 66 of 1995 read with section 136(1)(a) (i) or (ii).

²⁹³ Labour Relations Act 66 of 1995, section 189A(3).

²⁹⁴ Labour Relations Act 66 of 1995, section 189A(3)(a).

²⁹⁵ Labour Relations Act 66 of 1995, section 189A(3)(b).

²⁹⁶ Labour Relations Act 66 of 1995, section 189A(7)(a) read with section 37 of the Basic Conditions of Employment Act 75 of 1997.

²⁹⁷ Labour Relations Act 66 of 1995, section 189A(7)(b) read with section 191(11).

²⁹⁸ Companies Act 71 of 2008, section 144(4).

²⁹⁹ Companies Act 71 of 2008, section 144.

proceedings³⁰⁰ as well as making submissions and motions to approve a business rescue plan.³⁰¹ Rights of employees during business rescue were considered in *Solar Spectrum Trading* 83³⁰². In this case rescue proceedings were initiated by employees of the company. The court, per Kollapen J, analysing the scope and existence of a reasonable prospect commented on the interests of employees in a company's affairs as follows:

Clearly a shareholder is likely to possess greater details of a company's financial position and its financial performance than an employee. On the other hand employees...would have peculiar information of a company's performance being as it were at the centre and at the heart and soul of its operations. Their knowledge of the company's history, the highs and lows of its performance, the problems and the solutions identified and their own role in any business rescue would just be as relevant.³⁰³

Kollapen J held further that

without suggesting that different tests should be applied in establishing whether the threshold of reasonable prospects has been met, if the Act is to be implemented in a manner that does not disadvantage an employee as an affected party, then regard must be had both in assessing whether there are reasonable prospects and in exercising the balance of competing rights to the different positions of the parties in relation to the company.³⁰⁴

The court was careful to emphasise that it did not seek to create a different test for reasonable prospect. However, even though not having substituted the test of reasonable prospect with another, it may have introduced an additional overarching dynamic of employee rights and interests as a specific consideration in its assessment of reasonable prospect. Due to the court not having expounded on this aspect at length, it remains to be seen how it will be dealt with in future, specifically where business rescues are initiated by the company's employees. It is submitted that the concept of reasonable prospect should be limited to an analysis of the prospects of proceedings enabling the company to meet the objectives of business rescue.

4.10. FUTURE OF THE COMPANY: ADEQUATE PROTECTION FOR WHOM?

The business rescue practitioner must convene a meeting of creditors within ten business days of having published the business rescue plan.³⁰⁵ He/she must further provide notice at least five business days before the meeting setting out the venue,

³⁰⁰ Section 144(3)(a), participation rights in relation to court proceedings and the development of a business rescue plan are listed in sections 144(3)(b), (d) & 148.

³⁰¹ To the extent that such employees are creditors of the company 144(3)(e) and (f).

³⁰² *The Employees of Solar Spectrum Trading 83 v Afgri Operations Ltd and Another supra*.

³⁰³ At para 18. The concept of reasonable prospect has been discussed in the earlier part of the chapter. The judgment outlined this aspect within the context of its broader discussion of the role of employees in business rescue as affected persons.

³⁰⁴ At para 18.

³⁰⁵ Companies Act 71 of 2008, section 151(1).

time, agenda as well as a summary of the rights of affected persons who will be participating and voting.³⁰⁶

In the meeting the practitioner is required to perform a variety of functions including introducing the proposed plan for consideration by creditors and shareholders (where applicable), informing creditors as to whether he/she believes the company to be capable of being rescued as well as entertain any motion to amend the business rescue plan.³⁰⁷ The Act distinguishes between ‘amending’ a plan and ‘revising’ it.³⁰⁸ Where a creditor desires a plan to be amended a motion must put forward and seconded by another creditor in attendance before it can be voted upon by creditors.³⁰⁹ By contrast, where a creditor seeks a revision of the plan, the creditor may ‘direct the practitioner to adjourn the meeting in order to revise the plan for further consideration’.³¹⁰ There is no further requirement of a secondment of a motion in the latter scenario. Possible reason(s) why such distinction is created by the Act are unclear.

A proposed business rescue plan requires a 75% majority vote by creditors’ ‘voting interest’.³¹¹ Of this percentage, at least 50% must comprise independent creditors.³¹² There does not seem to be any minimum quorum requirements by the Act. It would therefore seem that if a major creditor were not in attendance at such meeting, a 75% vote in voting interest, by creditors in attendance (or voting by proxy) is sufficient.³¹³

Discussing this provision, the court *a quo* in *Kariba Manufacturing* confirmed that once a plan is adopted, it is binding on the company as well as on each of its creditors and holders of security, whether or not they are present at the meeting,

³⁰⁶ Section 151(2). The rights of employees to participate in the meeting are stipulated in the provisions of sections 144, 148 and 149 of the Act.

³⁰⁷ Companies Act 71 of 2008, section 152(1)(a) to (d).

³⁰⁸ The Oxford dictionary defines these terms as follows: Amend ‘1. To make minor improvements to (a document, proposal, piece of legislation etc.) 2. Put right’. Revise ‘1. Examine and improve and amend (something, especially written matter). Reconsider and alter (an opinion or judgment) 2. Reread work done previously to improve one’s knowledge, typically for an examination.’

³⁰⁹ Companies 71 of 2008, section 152(1)(d)(i). It would seem that simple majority in support from creditors suffices; see section 147(3). However, this is somewhat unclear in light of the fact that section 151 cannot be read in isolation from section 152, which specifically deals with the content and procedure in relation to the proposed business rescue plan.

³¹⁰ Companies Act 71 of 2008, section 152(1)(d)(ii).

³¹¹ The Act specifically makes use of this term in regulating voting by creditors. A ‘voting interest’ is in turn determined by the value of a creditor’s claim against the company. It seems rather peculiar that the Act does not make direct reference to the ‘value’ of a claim instead.

³¹² Companies Act 71 of 2008, section 152(2).

³¹³ A creditor must submit its claim against the company. The creditor must therefore be physically present or vote by proxy. Companies Act of 2008, section 152(4).

proved their claims or voted in favour of the plan.³¹⁴ The provision was described as having the effect of sanctioning a plan where the requisite majority has been reached, despite dissenting creditors. This process is commonly referred to as a ‘cram down’.³¹⁵ In relation to the application of ‘cram down’ in the United States, the court observed further:

Since ‘cramdown’, is a process by which creditors are forced to accept a re-organisation or a business rescue plan, even against their wishes, it has the incidental effect of discouraging creditors from resisting or holding out for better treatment, and it enables a business rescue or re-organisation to proceed despite the objections of one or more disgruntled creditors.³¹⁶

A question remains. Are creditors not entitled to resist in the hope of a better offer? Where a creditor is unreasonable in its holding out, the practitioner or an affected person is entitled to have such rejection set aside on ground of being inappropriate.³¹⁷ In such instance, the court would undoubtedly be in a better position to evaluate whether or not the actions of such creditor were inappropriate. The provision relating to a ‘binding offer’ reads as follows:

(ii) any affected person, or combination of affected persons, may make a binding offer to purchase the voting interest of one or more persons who opposed adoption of the business rescue plan, at a value independently and expertly determined, on the request of the practitioner, to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated...³¹⁸

The provision has potentially far reaching effects, and is distinguishable in its content to section 144(2), providing rights which are not as equally far reaching to employees.³¹⁹ The manner in which the two provisions³²⁰ have been drafted is somewhat similar even though the potential implications are vastly different in impact to the dissenting creditor. While section 144 makes reference to ‘present[ing] an offer’, section 153 makes use of a firmer tone of language which may have resulted in possible confusion regarding the intended meaning and ambit of the phrase ‘binding offer’ as well the envisaged purpose of section 153 by the legislature.³²¹

³¹⁴ *Kariba* at court *a quo* at para 28.

³¹⁵ *Kariba* at court *a quo* at para 28.

³¹⁶ *Kariba* at court *a quo* at para 29.

³¹⁷ Section 153(1)(a)(ii). See also the approach of courts in assessing the reasonableness of a creditor’s decision to vote against a plan, discussed earlier. On the content of ‘inappropriate’, see *Ex parte: Bhidshi Investments CC* (20189/14) [2015] ZAGPPHC 783 (7 October 2015); *Shoprite Checkers (Pty) Ltd v Berryplum Retailers CC and Others supra* at para 38; *Senwes Limited v Zellenhen Boerdery CC and Others; Zellehen Boerdery CC v Senwes Ltd* (50799/2015, 50486/2015) [2016] ZAGPPHC 373 (31 March 2016).

³¹⁸ Section 153(1)(b)(ii).

³¹⁹ Section 144(3)(g)(i-ii).

³²⁰ Companies Act 71 of 2008, sections 144(3)(g)(ii) and 153(1)(b)(ii).

³²¹ See observations made by the court in *DH Brothers supra* at paras 49 & 50.

A binding offer, which cannot be rejected by the offeree, has a potentially detrimental effect for a creditor who may be vulnerable (due to a lack of security against the company) and attempts to get the best deal for itself out of the process through its voting power. If a voting interest is capable of being expropriated without the creditor's consent (if a binding offer is accepted as capable of effecting this), what further recourse does such creditor have in attempting to salvage monies invested and essentially lost in the ailing company under rescue in light of the effect of section 152(4) and section 154(2)?³²² Does such 'offer' not put the common law maxim regarding the permissible extent of infringement on a creditor's rights at the mercy of an amorphous concept of public interest? As will be seen, the courts have not been *ad idem* regarding the concept of a binding offer. Greater scrutiny of this aspect, as interpreted in case law, follows.

4.11. THE KARIBA DILEMMA³²³

In this case the African Banking Corporation, the applicant, sought relief from the court in business rescue proceedings pertaining to Kariba Furniture Manufacturers. Having voted against the business rescue plan, a binding offer was made to the applicant, resulting in a divestiture of its voting interest. African Banking Corporation's claim resulted from monies it had, as a bank, advanced to Kariba. The monies were covered by a general notarial bond, which was executed by the company in favour of the bank.

The issue that the court had to determine related to the meaning of the term 'binding offer' in the Companies Act of 2008. Specifically, the bank sought a declaratory order to the effect that the binding offer made by Kariba was only binding on the offeror (Kariba) and that the offeree (African Banking Corporation) was free to either accept or reject it, alternatively that section 153(1)(b)(ii) was unconstitutional.

The court held that the binding offer in section 153(1)(b)(ii) had the effect of creating a legal obligation.³²⁴ This obligation was not in the same manner as an option or agreement.³²⁵ It was held that the offer rather comprised of a set of statutory rights

³²² A possible interpretation of these sections will be offered at a later stage.

³²³ *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* (GNP) [2013] ZAGPPHC 259; [2013] 4 All SA 432 (GNP); 2013 (6) SA 471 (GNP) (29 August 2013).

³²⁴ *Kariba* at *a quo* at para 29.

³²⁵ *Kariba* at *a quo* at para 29.

and obligations from which neither party could walk away.³²⁶ The court found that a binding offer, once made, had the effect of binding both offeror and offeree.³²⁷

In determining the value of the divested interest as well as the moment at which divestiture occurs, the court in *Kariba* said:

The determination of the value of the voting interest, by an independent expert, will only be effected *after* adoption of the revised business plan on the request of the practitioner, and as prescribed in s 153(1)(b)(ii) of the Act. The Act *does not* require the determination of the value by the independent expert, and payment of the purchase price of the offer to be made in the five day period contemplated in s 153(4)(a) of the Act. That period is reserved *purely* to afford the practitioner the opportunity to make any necessary revisions or amendments to the business rescue plan, to appropriately reflect the results of the offer, and to set a date for a resumed meeting, at which the revised plan will be considered afresh in terms of s 152 of the Act.³²⁸

In the context of this *dictum*, it may be argued that the court envisages a divestiture of a dissenting creditor's voting interest without consideration being paid for the interest at the moment the divestiture occurs. The creditor finds itself no longer possessed of the voting interest as well as not knowing the actual value that it might receive for it. It is sufficient that an independent expert provides an estimate of value and this may occur after the re-vote and after divestiture has occurred.³²⁹

The court in *Kariba* held that the practitioner would be entitled to commence implementation of the plan only once payment for the creditor's interest was effected.³³⁰ This approach was viewed as providing an added layer of protection in that were the company to default in making payment, the company would be unable to implement the plan.³³¹ The view was that in addition to a practitioner's inability to implement the plan in such instance, the divested creditor would remain capable of enforcing any debt owed by the company prior to business rescue to the extent that the creditor had not received payment for the interest, despite the occurrence of divestiture.³³²

If it is accepted that the binding offer is (i) a set of statutory rights and obligations rather than an 'option' or 'agreement' which (ii) finds application whether the offeree consents to it or not,³³³ which (iii) has the effect of divesting the offeree

³²⁶ *Kariba* at *a quo* at para 29.

³²⁷ *Kariba* at *a quo* at para 29. This approach was rejected in the subsequent *DH Brothers* case. The court disagreed with the interpretation of a 'binding offer' as a 'set of statutory rights and obligations' at paras 39 and 40.

³²⁸ My emphases. *Kariba a quo* at para 30.

³²⁹ *Kariba* at para 30. There are a myriad problems regarding the determination of a hypothetical value that would have been receivable in liquidation. A comprehensive discussion of this aspect is unfortunately beyond the scope of this thesis.

³³⁰ *Kariba a quo* at para 33.

³³¹ *Kariba a quo* at para 33.

³³² *Kariba a quo* at para 34.

³³³ Accepting that the estimated value is in accordance to what it may have received at liquidation.

creditor of its voting interest, the legal basis on which it may still enforce its rights where it has not received payment for its interest is not clear.

It would seem that the court distinguishes between a creditor's voting interest and the underlying enforceable claim, which forms the basis of the interest. Therefore a creditor may forfeit the interest while retaining the underlying claim, which will enable enforcement as long as payment for the 'divested' voting interest has not occurred. Upon further analysis, in the court's view the binding offer divests the interest while the enforcement right remains intact, with payment effecting a cession of the underlying right without prior agreement, explicit statutory injunction or consent. It would seem that the binding offer adverted to by the court results in a suspensive arrangement prior to payment occurring³³⁴ (and complete divestiture) taking place once payment has occurred.³³⁵ It is to be remarked that the relevant provision makes reference only to a binding offer to purchase a voting interest.³³⁶

It is difficult to find any other basis on which a creditor would be entitled to enforce a claim in the circumstances outlined by the court. If the above understanding of the court's articulation of 'binding' offer is correct, the conclusion reached in the judgment is seemingly contradictory. In addition and as the court correctly pointed out in *DH Brothers*, the determination of what would have been received by a creditor in liquidation presents a myriad of challenges and much room for abuse.³³⁷

The legal point has been settled on appeal.³³⁸ Rejecting the decision of the court *a quo*, the court observed a primary distinction between the 'binding offer' referred to by the court of first instance and that finding application in the U.S. Bankruptcy Code:

...However it seems to me that certain factors distinguish the process as provided for in our Act from the procedure provided for in the [United States] Bankruptcy Code...A further and more pertinent distinguishing factor is that the making of the binding offer in our business rescue procedure is a step separate and antecedent to the second round of voting on the adoption of the business rescue plan. Therefore the meaning of 'binding offer' falls to be considered on its own merits and separately from the merits of a rescue plan.³³⁹

The court provided the following interpretation to the word 'offer'

...In everyday use, the word 'offer' signifies a presentation or a proposal to someone for

³³⁴ And in this way results in a forfeiture of the voting interest only.

³³⁵ The divestiture of the underlying enforceable right.

³³⁶ Companies Act of 2008, section 153(1)(b)(iii).

³³⁷ The approach of the court in *DH Brothers* has received approval in subsequent cases. See the *obiter* remarks in the *ABSA v Caine* at para 37 and *Dowmont* cases *supra*.

³³⁸ *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* [2015] ZASCA 69 (20 May 2015). This judgment has been affirmed in the *Ranier Maria Scherzinger and Others v Motorstars Action Vehicles CC and Others* (Western Cape High Court) case numbers 6765/2015 & 11191/2015 of 3 December 2015 (Western Cape High Court) at paras 45-7.

³³⁹ *Kariba SCA* at paras 16-17.

acceptance or rejection; it is ‘an expression of readiness to do or give something; [or] an amount of money that someone is willing to pay for something’. In South African legal parlance, an offer is an invitation to consent to the creation of obligations between two or more parties... Therefore, the settled meaning, both in the general use and in the more technical legal use of the word “offer” is that it is only on acceptance that an offer creates rights and obligations.³⁴⁰

The court found that it is a legal requirement that an offer be clear, unambiguous and contain the minimum requirements of a proposed contract.³⁴¹ The bank was entitled to know who was making the offer, the value of such offer as well as when and how payment was to be made.³⁴² Mere regurgitation of the provisions of section 153 was insufficient for the purposes of constituting an offer.³⁴³

On the meaning of the term ‘binding’, the court confirmed the approach of Gerven J in *DH Brothers*³⁴⁴, and held that this meant that once an offer was made, it could not be withdrawn by the offeror. The court further held that to adopt the interpretation of the court *a quo* was to deprive an offeree of an established right to accept or reject an offer, observing that had the legislature intended to do so, this would have been clear from the legislation.³⁴⁵

The court of appeal has confirmed the layer of protection introduced by the court in the earlier *DH Brothers* case. This approach will go a long way to curbing potential abuse and collusion. The company has a remedy where a creditor’s vote is inappropriate.³⁴⁶ On a conspectus of available facts, the court is in a better position to determine this aspect.

4.12. A REVERSIONARY RIGHT FOR DISSENTING CREDITORS?

The provisions of the Act in relation to voting and adoption of the proposed business rescue plan have a tremendous impact on the rights of creditors.³⁴⁷ This impact becomes more pronounced when the provisions relating to the discharge of debts and claims against the company are considered.³⁴⁸ The relevant provision reads as follows:

154(1) A business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has *acceded* to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it.

³⁴⁰ *Kariba* SCA at para 18.

³⁴¹ *Kariba* SCA at para 19.

³⁴² *Kariba* SCA at para 19.

³⁴³ *Kariba* SCA at para 19.

³⁴⁴ *DH Brother supra* at paras 40-41.

³⁴⁵ *Kariba* SCA at para 21.

³⁴⁶ Companies Act 71 of 2008, section 153(1)(a)(ii).

³⁴⁷ Companies Act 71 of 2008, sections 152 & 153.

³⁴⁸ Companies Act 71 of 2008, section 154.

- (2) If a business rescue plan has been *approved and implemented* in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.³⁴⁹

Section 154(1) states that once adopted, the business rescue plan may provide for the discharge of the whole or part of a debt owing to a creditor, causing the creditor to lose the right to enforce the relevant debt.³⁵⁰ The word ‘implement’³⁵¹ is not defined, even though reference is made to ‘substantial implementation’ in Chapter 6.

Notwithstanding the above, the question to be answered is how are the provisions of sections 152 and 154 to be reconciled, especially in instances where a creditor has not consented to the compromise of a debt due and owing to it? Section 154(1) provides a suspensive condition for the enforceability or non-enforceability of a claim on the part of a creditor. The provision specifically uses the words ‘acceded to’³⁵², which may be accepted as being synonymous with the word ‘consent’³⁵³. It is submitted that the word presupposes the existence of consent, requiring positive action on the part of the person acceding or consenting. This may be contrasted with the word ‘acquiesce’³⁵⁴, where permission may be assumed in the absence of positive action on the part of the person ‘acquiescing’. With the latter, mere lack of positive action suffices.³⁵⁵ Where accession does not exist, there cannot be ‘discharge’. I argue that if section 154(1) is interpreted in this manner; it may serve to add a further layer of protection for creditors.³⁵⁶

How is the requirement of specific consent, as argued for above, to be reconciled with section 152(4) which deems an adopted business rescue plan to be

³⁴⁹ My emphases.

³⁵⁰ Companies Act 71 of 2008, section 154 (1).

³⁵¹ The South African Concise Oxford Dictionary (2009, Tenth Impression) at 579 defines the term’s secondary meaning as to ‘put into effect.’

³⁵² The Concise Oxford Dictionary defines the word as ‘1. assent or agree..’

³⁵³ Denoting ‘permission or to give permission, agree to something.’ Concise Oxford Dictionary *supra* at 245.

³⁵⁴ Defined in the Concise Oxford Dictionary at 9 as to ‘accept or consent to something without protest.’

³⁵⁵ However, see the observations made by *Meskin et al* in Henochsberg at 536.

³⁵⁶ As correctly observed by *Meskin et al*, section 152(4) and its possible effect on this view cannot be ignored. It provides that an adopted plan is binding on creditors and security holders of the company whether or not they were present, had voted for or against the plan or had proven their claim against the company. It may be argued that this provision imposes a deemed accession to the plan once the requisite majority has been satisfied therefore satisfying the condition in section 154(1) and rendering an individual creditor’s dissent legally irrelevant. A contrary argument may be that section 152(4) refers to the legal effect of an adopted plan (i.e. binding) while section 154(1) refers to the existence of individual consent, notwithstanding the act of adoption (i.e. presence or absence of accession).

binding on all creditors irrespective of whether they were present or voted in favour or against the plan? The courts seem to be providing some guidance on this aspect. In an *obiter* remark, the Supreme Court of Appeal in *Newpoint Finance Co* observed the effect of section 154 on a creditor's claim:

The key provision in that regard is s 154, which, in subsec 1, simply says that in certain circumstances a creditor will not be able to enforce a debt against a company in business rescue and, in subsec 2, says that the company may enforce a debt in accordance with and to the extent permitted by the terms of the business rescue plan. That section is capable of the construction that it deals only with the ability to sue the principal and not the debt itself. If that is the case then the liability of the surety would be unaffected by the business rescue, unless the plan itself made specific provision for the situation of sureties...³⁵⁷

It would therefore seem that the section does not affect the anatomy of the claim itself but rather its enforceability. Therefore, once adopted by creditors, a creditor remains with its claim but is simply unable to enforce it. It would be unfair to the debtor company and contrary to the objective of business rescue³⁵⁸ if a creditor were to consent to the compromise of its claim in terms of section 152 and subsequently, for whatever reason, unilaterally seek to enforce the previously compromised claim in full in the absence of a breach of the rescue plan. It is submitted that such a situation is one which the legislature would clearly have sought to prevent and that the sub-section was intended for such instances.

Section 154(2) states that where a business rescue plan has been 'approved and implemented', a creditor is not entitled to enforce any claim which arose immediately before the proceedings unless the rescue plan provides otherwise. The problem with this provision may be illustrated by the following: Company A enters proceedings. In terms of its proposed business rescue plan, there is an undertaking to perform actions x y in return for a compromise of claims. Creditors of Company A adopt the proposed plan. The practitioner performs only action x and files for substantial implementation.

Due to the existence of 'approval' (in the form of plan adoption) and a degree of 'implementation' (whether complete or not) having taken place, the provisions of section 154 are in large part satisfied leaving the creditor unable to enforce its claim upon mal-performance.³⁵⁹ In this case a creditor is unable to set aside the resolution which placed the company in business rescue. Creditor recourse is unclear (even if it is assumed that the creditor has the financial capital to litigate). Should one of these

³⁵⁷ At para 14.

³⁵⁸ See definition of 'business rescue' in section 128.

³⁵⁹ However, some recourse is available to an affected person with respect to practitioner plan implementation as articulated in cases considered earlier.

two agreed upon conditions not be satisfied, a creditor ought to be entitled to enforce its claim.³⁶⁰ Interpreting the sub-section in this manner provides a positive response to the ambit of a creditor's right to vindicate its claim against the debtor company.³⁶¹

The advantages of the provision being interpreted in this manner are (i) it resolves the challenge identified by the courts, regarding the Act not providing for the setting aside of the resolution once the business rescue plan has been adopted³⁶² and (ii) counter-balances the potentially infringing effect that business rescue has on the enforcement rights of a creditor. This approach strikes a better balance between the common law maxim affirmed in *DH Brothers* and the socio-economic imperatives highlighted in the Act.

The proposed approach is especially relevant in light of the fact that the scope for creditors to vindicate their rights seems to have been significantly limited by the Supreme Court of Appeal in *Panamo Properties (Pty) Ltd*. The court disagreed with the approach of the court in the earlier *DH Brothers* case, where the court in *DH Brothers*, in order to reconcile the inconsistency between sections 130(1)(a) and 130(5)(a) and avert potential injustice, introduced a fourth ground for setting aside proceedings ('just and equitable circumstances').³⁶³

³⁶⁰ Where not entitled to unilaterally enforce its claim, such creditor ought to be entitled to approach the courts for the setting aside of the company resolution even after the plan has been adopted, provided that some form of notice regarding breach and opportunity to remedy same is given to the debtor company.

³⁶¹ The court in *Merchant West Capital Solutions supra* at para 74 made a number of observations, highlighting challenges in relation to the vague drafting of the Act and its omission in respect of dealing with aspects such as breach, the failure to properly define 'implementation' or 'substantial implementation' and the limiting effect this has on a creditor's right of recourse. See *DH Brothers supra* at para 67.

³⁶² There may be legitimate reasons why creditors may wish to adopt this course of action. Some of these could be where there has been mal-performance or no performance of legal obligations on the part of the company in terms of the adopted plan and in the absence of a default/cancellation clause. The Supreme Court in *Panamo Properties supra* at para 13 has confirmed the position that once a business rescue plan has been adopted by creditors, an affected person may not make application to have the director's resolution envisaged in section 129 set aside. In *Absa v Naude supra* at 12 the court declined an invitation to expound on this issue, finding that a discussion of this aspect within the context of section 233 would be *obiter dictum*. Concluding that the applicant no longer possessed requisite *locus standi* to set-aside proceedings where the proposed plan was adopted, the court in *Suidwes Landbou (Pty) Ltd v Wynlandi Boerdery CC and Others* (1510) [2014] ZANWHC 5 (20 March 2014) at para 7 observed that:

'...it could never have been the intention of the legislature to provide for the above-mentioned remedy in section 130(1), yet, at the same time, provide for the possibility of a single creditor to pursue its claim outside the ambit of the business rescue plan adopted in terms of section 150...'

However see *Absa Bank Limited v Golden Dividend 339 (Pty) Ltd and Others* (70637/13) [2014] ZAGPPHC 1048; 2015 (5) SA 272 (GP) (19 December 2014) where the court, notwithstanding the fact that an applicant sought to set-aside an already adopted plan, observed that it was relevant that proceedings were launched before the plan was adopted and that this distinguished it from *Kariba* at *a quo* where proceedings were launched after the plan was adopted.

³⁶³ *DH Brothers supra* at para 18.

The Supreme Court of Appeal held that despite non-compliance with the procedural requirements of section 129, resulting in nullity³⁶⁴, this would not result in a termination of proceedings.³⁶⁵ An application to court was a necessary pre-condition for termination.³⁶⁶ Having expressed caution regarding the court substituting its own view for what it believes the legislature may have intended a provision to mean as well as emphasising the ordinary language used as the primary point of departure, the court replaced ‘or’ in section 130 with ‘and’.³⁶⁷

On a reading of the judgment, in order for the court to set aside a resolution in terms of section 130(5)(a), for example, a creditor would, despite having possibly set a substantive basis in the form of showing absence of a reasonable prospect³⁶⁸, in addition have to show that it is ‘just and equitable’ for proceedings to be terminated. The same requirement would have to be met where an applicant seeks termination on the basis of non-compliance with what the court terms ‘obligations of an administrative or procedural nature’ in section 129. The applicant would have to satisfy the court that termination is just and equitable.³⁶⁹

Unfortunately, the SCA seems to have further minimised if not eliminated the possibility of a reversionary right for creditors in *Eravin Construction*³⁷⁰. In brief, Ditona, a company under final liquidation, had made transfer to Eravin of an amount of R 389 593.49 after which the latter entered business rescue proceedings. The liquidator sought to avoid the transfer as a void disposition in terms of section 341(2) of the Companies Act of 1973. Finding that it was not necessary for creditors to have received notice of business rescue proceedings for section 154(2) to come into force, the court decreed:

...The meaning of the section is clear and unambiguous: all creditors- as opposed to creditors who had been given notice of the business rescue proceedings- are precluded from enforcing pre-business rescue debts. I can see no justification for reading into the section a limitation that the legislature would have provided expressly, had it wished to...To the extent that some creditors may not know about the business rescue proceedings until after they have concluded, that may indicate a defect in the provisions of the new Act concerning the giving of notice. If that is so, that is a matter for the legislature to attend to. It is not the proper function of the court to attempt to remedy such difficulties by means of interpretive sleight of hand.³⁷¹

³⁶⁴ In terms of section 129(5).

³⁶⁵ *Panamo Properties supra* at para 28.

³⁶⁶ *Panamo Properties supra* at para 28. This application would be in terms of section 130(5)(a).

³⁶⁷ At para 31. For further reading, see further *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2013] ZASCA 13 cited with approval by the same court at para 26.

³⁶⁸ Or an absence of financial distress in terms of section 130(1)(a).

³⁶⁹ *Panamo Properties supra* at paras 21, 32 and 33.

³⁷⁰ *Eravin Construction CC v Bekker NO and Others* (20736/2014) [2016] ZASCA 30 (23 March 2016). The court further affirmed its own earlier ruling in *Panamo Properties* on the nullity debate.

³⁷¹ At paras 27 and 29. See *Stalcor (Pty) Ltd v Kritzinger NO and Others supra* at para 41.

From a reading of the *Panamo* and *Eravin Construction* judgments, it would seem that proceedings commenced in a manner which is non-compliant with the formal prescripts of the Act are in substance putative rather than ‘a nullity’ as envisaged by the Companies Act.³⁷² In addition, where for example a company fails (whether deliberately or through negligence) to publish relevant notice to affected persons and proceedings come to end (or even where they reach the stage where the plan was voted upon and adopted by creditors who were notified and participated), a creditor virtually has no recourse. The potential dangers for abuse of the regime are glaring.³⁷³

4.13. FURTHER GAPS IN CURRENT LEGISLATION

Business rescue provisions in Chapter 6 present a significant departure from the previous judicial management regime. Despite the level of innovation shown in the drafting of the chapter, the new regime contains loopholes and weaknesses not unique to newly drafted legislation. While others have been highlighted throughout the chapter, some are explored in the following paragraphs.

Due to the degree of flexibility afforded to an entity in seeking recourse to proceedings, Chapter 6 may be subject to abuse by companies wishing to illegitimately receive the benefit of compromising debts due to creditors. This may be even more of a risk where proceedings are commenced by board resolution.³⁷⁴

There is no explicit requirement in terms of the Act that the affidavit be accompanied by independently audited financial statements of the company as a way of verifying averments made when it is filed with the director resolution at CIPC³⁷⁵. A requirement to this effect would enable the Commission to better assess whether

³⁷² Putative in the sense that they are considered to be of force and effect until successfully challenged.

³⁷³ An example may be in the context of group structures. Time periods applicable to confirmation of a liquidation order in one connected entity are not necessarily congruent with timelines applicable with timelines of a business rescue intervention to which another group company may be subject. By the time a liquidator’s appointment has been confirmed, it may be impossible to recoup monies or assets transferred to a connected company. Where there is knowledge of proceedings, this may not be much of a problem but as the *Eravin Construction* case shows, it is not infrequent that relevant parties gather knowledge when it is effectively too late.

³⁷⁴ Pretorius (Business Rescue Status quo report) having collated data on business rescue over three years (from 1 May 2011 until 31 July 2014) observed that 90% of filings were through resolution of the board of directors while commencement by court order accounted for just below 10%. With commencement by court order, a 50-50 split between creditors and shareholders making application to court was observed (with the exception of three cases where employees had made application).

³⁷⁵ Companies and Intellectual Property Commission.

financial distress exists or not.³⁷⁶

Within the context of inter-related entities, it is not entirely clear whether a suretyship obligation which becomes enforceable but is not yet enforced against a company in business rescue may cause the requirement of ‘financial distress’ to be met in a connected co-principal debtor company. In group structures, where there are a number of sureties in favour of connected parties, the financial distress of one of the companies often triggers business rescue proceedings in related companies who may be property owning, often not receiving sizeable income but whose business asset is often property over which a creditor may, through the suretyship, have security.

In this way, rescue proceedings may be used as a creditor ‘staving-off’ mechanism.³⁷⁷ This is not to detract from the fact that as surety and co-principal debtor, the connected company is potentially liable for debt incurred by the principal debtor.³⁷⁸ The question is whether considering this contingent liability and the definition of ‘financial distress’, would recourse to proceedings by such connected company be seen a valid use of the procedure? Such issues often bring the legitimacy of initiating proceedings into doubt. The question remains, whether this course of action was envisioned by legislators and therefore intended or whether it is a consequence that was neither foreseen nor intended.³⁷⁹

³⁷⁶ Even if it is accepted that cash flow insolvency and the prospect of factual insolvency occurring within a six month period are the correct tests for the purposes of initiating business rescue. Even though a comprehensive discussion of this aspect is beyond the scope of this thesis, the approach adopted by Australian courts may assist us in unravelling this complex terrain. For further reading see *Re Capital Annuities Ltd* [1979] 1 WLR 170 at 182-188; *Re a Company* [1986] BCLC 261 at 261; *Re RHD Power Services Pty Ltd* (1991) 3 ACSR 261; *Lewis v Doran* [2005] NSW 243; *Sandel v Porter* (1966) 115 CLR; *Hymix Concrete Pty Ltd v Garrity*; *M & R Jones Shopfitting Co (Pty) Ltd v National Bank of Australasia* (1983) 7 ACLR at 445.

³⁷⁷ The courts have commented on the *fides* of a party wishing to initiate proceedings intimating that they would be loath to sanction business rescue proceedings where such is initiated in bad faith and amounted to an abuse of process. See *Sulzer Pumps (South Africa)* and *Beagle Run Investment cases supra*.

³⁷⁸ Levenstein (LLD thesis) highlights additional complexity faced within the context of business rescue, as well as the effect the construction of a suretyship agreement has on enforceability (i.e. the question whether a ‘co-principal’ debtor relationship exists between the principal debtor and surety or not):

‘...Many financial institutions have removed reference to “co-principal debtor” from their standard suretyship agreements as a result of the provisions set out in the National Credit Act... However, it is submitted that this becomes problematic when one considers the implications of section 133 of the 2008 Companies Act in that no legal proceedings can occur against the company once business rescue proceedings have commenced. As a result, this would prohibit the bank from proceeding against a surety on the basis that 2008 Companies Act will prohibit action to be taken against the principal debtor, namely the company. Once such valid underlying obligation becomes tainted from an enforceability point of view, the bank will not be entitled to proceed against the surety itself.’

³⁷⁹ A related matter seems to be the Act’s silence on group companies business rescues. It would seem that this was not envisaged by the legislature.

There is no express requirement, on the ordinary wording of section 129, that the resolution to be filed to CIPC must be accompanied by a sworn statement at that stage. The section provides for a sworn statement where notice is to be sent to affected persons as the section makes use of the words ‘after the company has adopted and filed a resolution’.³⁸⁰ The current practice of CIPC is to require an affidavit to accompany the board resolution. In the absence of such affidavit the resolution is rejected. It may be argued that in insisting on an affidavit CIPC may be acting *ultra vires* and thus not competent to demand that an affidavit accompany the board resolution.

Section 129 remains vulnerable to manipulation. For example, even though a practitioner is required to convene a first meeting of creditors within ten days after appointment in terms of section 147, a practitioner may request an additional 14 day adjournment during a first meeting of creditors so as to ‘investigate’ the company’s affairs and its capability of being rescued in terms of section 141 while it may be *prima facie* clear on the conspectus of the available facts and from an objective standpoint, that the company either does not have reasonable prospects of being rescued or is not financially distressed. In this way the practitioner is able to siphon funds out of an already struggling company for a longer period. Slightly stronger controls are imposed by section 150, requiring the publication of a plan within 25 days after practitioner appointment.³⁸¹ One may argue that a 24-day period may not be significantly detrimental to the company financially. In light of the fees and disbursements that such practitioner may be entitled to levy against the company, such a view may be construed as naiveté.³⁸²

³⁸⁰ See section 129(3) whereas sub-section 3(a) requires a resolution to be sent to affected persons to ‘includ[e] a sworn statement of facts’.

³⁸¹ However see *Shoprite Checkers (Pty) Ltd v Berryplum Retailers CC and Others supra*, where the court, disagreeing with the earlier *DH Brothers case* held that despite non-compliance with the 25 day requirement, a litigant could on good cause request the court to extend this period even after its expiry. See further the discussion of the *Panamo Properties case supra* and its impact on this aspect.

³⁸² On the practitioner’s entitlement to charge fees and disbursements, even where the conclusion was that the company did not have reasonable prospects of success, see generally *Murgatroyd v Van Den Heerver N.O. and Others* (20456/2014) [2014] ZAGPJHC 142; [2014] 4 All SA 89 (GJ); 2015 (2) SA 514 (GJ) (29 July 2014) at para 49.

4.14. CONCLUSION

It may be argued that business rescue contains significant improvements when compared to its predecessor, judicial management. Being a company rescue measure designed from a comparative framework with a multi-stakeholder orientation, it attempts to perform the arduous task of ensuring that a company's stakeholders (rather than simply its creditors) are accorded varying degrees of protection when a company is liable to be liquidated.

The task has been made even more challenging by the often open-ended and sometimes complex drafting style of the provisions of Chapter 6, which has contributed to both abuse of the process and litigation. Many of the concerns raised in the chapter will hopefully be rectified through legislative amendment and active judicial participation.

The public interest orientation of business rescue has been consistently affirmed, placing a preference for rescue over liquidation where the requisite thresholds are met. Unfortunately, this has in some instances led to abuse of the process, primarily due to the relatively low administrative requirements that have to be met by a company's board in order to have recourse to the process.

Even though the ease with which a company may be able to access the procedure is a significant improvement, it is necessary that current information requirements be revisited by CIPC so as to ensure that companies that should be under business rescue are the ones benefitting from the process.

While not seeking to describe this new regime within a debtor (predominantly U.S. approach) or creditor in possession (primarily U.K. approach) mould, the nuanced manner in which Chapter 6 deals with stakeholders has received attention. In addressing this aspect, it has been argued that business rescue, despite its conceptual basis being from a collective-creditor orientation, places greater weight and protection on the rights of employees (as a specific category of creditors) when compared to other classes of creditors.

Employee rights may summarily be categorised into three broad forms: job security, security of participation and security of ranking. Despite wide powers granted to the business rescue practitioner, he/she may not unilaterally suspend or cancel contracts of employment. Any retrenchment decisions must comply with

sections 189 and 189A of the Labour Relations Act of 1995.³⁸³

Significantly, the practitioner may not approach the court to suspend or cancel employment contracts on any basis other than on the grounds outlined earlier. In this way the Companies Act of 2008 has limited the courts inherent jurisdiction in favour of employees, providing the latter with a limited form of exemption from judicial scrutiny. This reflects a significant paradigm shift, highlighted earlier in the chapter of the employee as the only creditor with ‘pride of place’ and reflects the permeating nature of labour legislation in the post-Constitutional context.³⁸⁴

In relation to participatory powers, the Act articulates the bases, throughout the process, on which the employee is able to participate. These powers are granted both in the collective (as a member being represented by a trade union) and individual (where not part of a union) senses. The manner in which the participatory rights of employees have been articulated have resulted to a large extent in duplication, as the employee is able to access certain rights both as an ‘employee’ as well as an ‘affected person’.

Information rights (right of access to company financial statements) that employees are granted in the Act are to the exclusion of any other category of creditor (to the exception of a shareholder-creditor or judgment creditor in certain circumstances).³⁸⁵ Therefore the employee creditor becomes the only independent creditor able to exercise a significantly greater level of creditor activism. The above is

³⁸³ Section 189 primarily vests employees with the right to be consulted by an employer where dismissals based on operational requirements are contemplated. The nature of the right is to procedural fairness. The purpose of consultations would *inter alia* be to explore options available so as to avoid or minimise dismissals, alter their timing, mitigate the negative effects of any proposed dismissals, as well as agree on a method for effecting dismissals. For cases on ‘procedural fairness’ within the context of the Labour Relations Act, see *SACTWU v Discreto* [1998] 12 BLLR 1228 (LAC); *FAWU v SA Breweries Ltd* [2004] 11 BLLR 1093 (LC); *Kukard v Molapo Technology (Pty) Ltd* [2006] 4 BLLR 334 (LC) at par 20. The courts have been at pains to emphasise the link between procedural and substantive fairness. In this regard, see *SACWU v Afrox Ltd* [1999] 10 BLLR 1005 (LAC); *BMD Knitting Mills (Pty) Ltd v SACTWU* [2001] 7 BLLR 705 (LAC); *NEHAWU v Medicor (Pty) Ltd t/a Vergelegen Medi-Clinic* [2005] 1 BLLR 10 (LC) at para 38. Section 189A provides that employees may in certain instances participate in a strike or lock-out during such period.

³⁸⁴ See section 210 of the LRA read with section 5 of Act 71 of 2008.

³⁸⁵ See section 31(3) of Act 71 of 2008. An ordinary creditor may only be able to access this information, in many instances, only after commencement of proceedings and after publication of the plan. Trade Unions are entitled to receive this information before proceedings have commenced, where they are desirous of initiating business rescue proceedings.

also reflective of possible structural information asymmetries³⁸⁶, which the Act may be said to be inadvertently perpetuating. There are, in this manner, no equally comparable rights vested by the Act upon other ‘independent’ creditors. These creditors may, however, be able to access similar information in terms of external legislation or regulation even though such may come at an additional cost.³⁸⁷

Chapter 6 articulates the manner in which employee claims are to be ranked both at the pre- and post-commencement stages. The ranking of employee claims evidences a clear departure from the judicial management regime, significantly swinging the pendulum in favour of employee creditors. The treatment of employee claims within judicial management has received discussion in the previous chapter.

The following aspects are worth highlighting: Pre-commencement outstanding remuneration claims are ranked as preferent and payable prior to concurrent creditors. The employee, having an equally protectable interest in relation to an ordinary concurrent creditor, is vested with a stronger pedigree of claim during rescue despite stronger protections (in the form of a preference in ranking in terms of insolvency law) should the company succumb to liquidation.

Further concern is evoked where the provisions regulating post-commencement finance are analysed. Once proceedings have commenced, remuneration obligations incurred by the company thereafter are categorised as post-commencement finance. While ranking ahead of pre-commencement concurrent and preferent creditors, wage claims falling into this category rank (i) only secondary to practitioner fees and business rescue expenses (ii) in priority to post-commencement secured and unsecured non-wage related financing/credit and in priority to (iii) pre-commencement secured and unsecured credit.³⁸⁸

Even more profound, is the impact of the above preference in a subsequent liquidation, where due to business rescue proceedings having been instituted, the ordinary preferent ranking of employees in terms of insolvency law is transformed

³⁸⁶ See Mongalo in his presentation ‘Two steps forward and one step back is better than one step forward and two steps back: A limited comparative analysis of business rescue in South Africa’ presented at the University of Pretoria 7 October 2014. He aptly explains application of the concept within the context of Chapter 6 of the Companies Act 71 of 2008 at 4. For a more comprehensive analysis, see Joseph Stiglitz ‘The Contributions of the Economics of Information to the Twentieth Century Economics’ (2000) 115 *jstor* 1441-1478; Le Roux, Ingrid and Duncan, Kelly ‘The naked Truth: Creditor understanding of business rescue. A small business perspective *SAJESBM Vol. 6* pp 57-74.

³⁸⁷ Either through litigation mechanisms such as ‘discovery’ or by seeking recourse through information legislation such as the Promotion of Access to Information Act 2 of 2000.

³⁸⁸ However see discussion of *Senwes Limited v Zellenhen Boerdery CC and Others; Zellehen Boerdery CC v Senwes Ltd supra*.

into a significantly stronger form of ranking and may create two categories of ranking for the employee.³⁸⁹ The crystalised ranking in the business rescue subsists in a subsequent liquidation.

These protections are disproportional in light of (i) the significant informational and participatory rights vested upon employees and (ii) the role played by other creditors in the functioning of the ailing company before and upon commencement of proceedings, specifically in view of (iii) the concessions expected from non-employee creditors as a collective in pursuance of company survival. In addition, an inherent risk is that the *status quo* may present room for legislative arbitrage and significant abuse.

The chapter has highlighted similarities in approach between our rescue regime and the approaches of the U.S. and the U.K. In the introductory part of the thesis, the hybrid nature of our rescue regime as well as its roots in both chapter 11 (U.S.) and administration (U.K.) procedures, has been affirmed. In light of business rescue's mixed conceptual roots, and especially in light of the challenges currently observed, it is apposite that we proceed to analyse, in greater depth, the administration and chapter 11 procedures. In the context current experiences with our own business rescue procedure, the analysis may provide invaluable insights into how our regime may be enhanced.

³⁸⁹ A different set of objectives, interests and dynamics come into play within the context of Insolvency Law when compared to the Companies Act. Its preamble simply reads; 'To consolidate and amend the law relating to insolvent persons and to their estates.' A strong argument may be made that once a company has failed to be rescued within the prescripts of the Companies Act, which specifically sets out to achieve this, a preference in ranking created by it should not have the effect of creating a preference in another Act especially where this has not been articulated as a legislative intention, in either or both Acts. On the other hand it may be argued that this is a necessary concession on the part of all stakeholders, if the company is to have a sound opportunity at recovery.

CHAPTER 5: COMPARATIVE APPROACHES - BANKRUPTCY AND ADMINISTRATION

5.1. INTRODUCTION

Since our new business rescue regime contains aspects which resemble the approaches of both the U.K. and U.S., albeit to differing degrees, it is for this reason that both are discussed. The benefits of engaging in this exercise are many. Because of comparative influence of these jurisdictions, there is an existing framework for comparability. The functional benefits of engaging in a comparative analysis of similar jurisdictions are well articulated by Zweigert & Kotz⁷⁶⁴:

The basic methodological principle of all comparative law is that of functionality. From this basic principle stem all other rules which determine the choice of laws to compare, the scope of the undertaking, the creation of a system of comparative law, and so on. Incomparables cannot usefully be compared, and in law the only things which are comparable are those which fulfil the same function.⁷⁶⁵

It is in this light that the chapter sets out to provide an analysis of the U.K. administration and U.S. chapter 11 procedures. The purpose of this analysis is two-fold. The first is to evaluate the question of whether either or both jurisdictions better balance competing interests during company insolvency. In this regard the chapter evaluates whether the respective approaches mediate conflicting stakeholder interests during insolvency in an efficiency enhancing manner. If the answer to the above is in the affirmative, the second is to consider learnings which can be extrapolated in order to potentially resolve the challenges identified.

The chapter discusses the mechanics of the administration and chapter 11 regimes. In relation to both, a detailed discussion of the following is entered into: (i) Rules relating to accessing the procedure. This includes a discussion surrounding applicable tests to be satisfied by the debtor as well as notice requirements (ii) Management-control of the debtor during proceedings (iii) Ambit and effect of the moratorium against claims (iv) Protection of creditor interests including an analysis of the extent to which both jurisdictions protect existing property and (or) security interests of creditors (v) Rules regarding the proposed plan of reorganisation (vi) Treatment of creditor claims. The enquiry into the treatment of claims is expanded to a discussion on distributions to pre-commencement creditors, as well as the ranking of post-commencement claims. Thereafter, the ascendancy of the creditor in the form of

⁷⁶⁴ K. Zweigert & H. Kotz *An Introduction to Comparative Law* (translation by Tony Weir) Oxford; Clarendon Press (1998).

⁷⁶⁵ Zweigert & Kotz (1998) at 15 and 34.

institutional lenders during the procedure is explored (vii) The treatment of employee creditors during proceedings is given specific attention and includes a brief examination of the extent to which obligations to employees may be varied as well as an evaluation of the prevalent trends in relation to the protection of employee interests.

The chapter concludes with a discussion of international instruments in the form of the UNCITRAL *Legislative Guide on Insolvency Law* and the extent to which the United Kingdom, United States and South Africa have followed its recommended approaches. Thereafter, an evaluation and brief comparison of the three regimes commences, highlighting features of the comparative jurisdictions which may assist in strengthening our own business rescue regime.

5.2. THE UNITED KINGDOM

5.2.1. NATURE OF ADMINISTRATION

Administration may be defined as a procedure which enables an insolvent company⁷⁶⁶ to enter into a process allowing it to either return to solvency or derive a higher premium for its creditors than in liquidation.⁷⁶⁷ There are a number of routes through which this may occur.⁷⁶⁸ Before delving into this in detail, an analysis of the purpose of administration is apposite.⁷⁶⁹

⁷⁶⁶ 'Insolvent' here is meant in both the cash-flow and balance sheet senses of the term.

⁷⁶⁷ A Keay and P Walton *Insolvency Law: Corporate and Personal* 2 ed (2008) Bristol: Jordan Publishing at 92.

⁷⁶⁸ Keay and Walton (2008) at 92. Some of these are given discussion in the chapter.

⁷⁶⁹ For a historical perspective, see Ian Fletcher *The Law of Insolvency* 2 ed (1996) London, Sweet and Maxwell at 13; Ian Fletcher 'UK Corporate Rescue: Recent Developments- Changes to Administrative Receivership, Administration and Company Voluntary Arrangements- The Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002' (2004) *European Business Organization Law Review* 5(1) 119. The work of a number of committees, which included the Muir Mackenzie Committee (1906, Cd.4068), the Hansel Committee (1925, Cmnd. 2326) and the Blagden Committee (1957, Cmnd 221) is historically relevant; Insolvency Law Review Committee *Insolvency Law and Practice* also known as the 'Cork Report' Cmnd 8558 published in 1982. For a brief synopsis of the history preceding this period see Harry Rakaj 'The Culture of Bankruptcy' in Paul J Omar (ed.) 2008 *International Insolvency: Themes and Perspectives* USA: Ashgate Publishing Company; J Cohen 'The History for Imprisonment for Debt and its relation to the Development of Discharge in Bankruptcy' (1982) 3 *Journal of Legal History* 153; DTi/ HM Treasury Report 'A Review of Company Rescue and Business Reconstruction Mechanisms' (London, DTi, 2000); Government White Paper *Insolvency- a Second Chance* Cm 5234 (July 2001) at para 2.1. The Enterprise Act of 2002 effectively followed from this paper; Insolvency Service *Productivity and Enterprise: Insolvency- A Second Chance* Cm 5243 (July 2001); Insolvency Service *Company Voluntary Arrangements and Administration Orders* 1993; See John Armour, Audrey Hsu and Adrian Walters 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5 *ECFR* 148 at 154; Andrew McKnight 'The reform of corporate insolvency law in Great Britain' (2001) 16 (8/9) *Journal of International Banking Law* 213.

5.2.2. PURPOSE OF ADMINISTRATION

Observations made in the Parliamentary Debates on the then Enterprise Bill by the House of Lords are instructive in providing a glimpse of some of the purposes that the reform to U.K. insolvency law hoped to achieve.⁷⁷⁰ Lord McIntosh of Haringey observed:

...Company rescue is at the heart of the revised administration procedure. We want to make sure that viable companies do not go to the wall unnecessarily. That is why we are restricting administrative receivership and revising administration to focus on rescue and to make it more accessible to companies as well as their creditors. That is not just good for the companies themselves; it is also good for their suppliers, customers and employees...⁷⁷¹

The Insolvency Act⁷⁷² caters for the achievement of a multi-purposed objective as the underlying *raison d'être* for the existence of administration proceedings. The relevant provision reads:

- 3(1) The administrator of a company must perform his functions with the objective of—
- (a) rescuing the company as a going concern, or
 - (b) achieving a better result for the creditors of the company as a whole than would be likely if the company were wound up (without first being in administration), or
 - (c) realising property in order to make a distribution to one or more secured or preferential creditors.⁷⁷³

The primary purpose⁷⁷⁴ is to ensure that the company is rescued as a going concern. This envisages the rescue of the company as a corporate entity.⁷⁷⁵ Should it not be possible to rescue the company, the second objective entails that the administrator ensures that proceedings yield a dividend higher than that realisable in liquidation for the benefit of creditors.⁷⁷⁶ The administrator will attempt to salvage the business even if it means stripping it from its corporate shell. This may include the sale of the company's business and machinery, goodwill, intellectual property and the transfer of employee contracts to a third party.

It has been observed that no specific reference is made to the wider interests of shareholders and employees in the language of sub-paragraphs 1(b) and 2. Fletcher observes:

⁷⁷⁰ House of Lords Debates Column 766, 29 July 2002.

⁷⁷¹ Ibid.

⁷⁷² 1986, Schedule B1.

⁷⁷³ Schedule B1 at para 3.

⁷⁷⁴ Even though the Insolvency Act applies the term 'purpose', the thesis makes use of both of this term and the term 'objective'. The latter term is applied as a synonym for the former.

⁷⁷⁵ Sandra Frisby 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 *Mod.L.Rev.* 247 at 249 and 260, agrees with this view. She observes that the Enterprise Act has moved away from a selective approach to rescue, focusing on a complete rescue as the default position.

⁷⁷⁶ In relation to this objective, see Keay and Walton (2008) at 95.

The policy approach underlying the combined provisions of paragraph 3(1)(b) and (2) seems to have been the desire to perpetuate the traditional disposition of English insolvency law to elevate the interests of creditors above the other possible benefits of a corporate rescue, including the preservation of shareholder value and continuation of employment that might be achieved. However, it can also be observed that a further consequence of sub-paragraph (2) is that the collectivity principle is accorded priority over the pursuit of an objective aimed at benefitting certain individuals (notably secured creditors) at the expense of others...⁷⁷⁷

Notwithstanding the observations made, employees, where affected, will likely fall into the broader category of creditors to whom the administrator owes a fiduciary duty and that no specific reference to employees is necessary.⁷⁷⁸ This raises the further question of the extent of preference for employee interests in comparison to other creditors. This is explored at a later stage.

Where achieving the second objective is not possible, the administrator may break up the company and conduct a sale of the company's assets in the interests of secured or preferential creditors.⁷⁷⁹ Due to it being virtually impossible to act in the interests of all creditors where the third objective is contemplated, the administrator's duty is to be construed in the negative sense; being a duty not to harm the interests of creditors and, at most, consider the interests of unsecured creditors even though this category may no longer have a financial interest in the rescue.⁷⁸⁰ A criticism that has been levelled is that administration on this basis is in fact quasi-liquidation with no legitimate intention to rescue and that the better alternative would be for the company to enter liquidation proceedings.⁷⁸¹

Even though the Insolvency Act provides for a grading of objectives, if there is a belief that the company cannot be rescued as a going concern or where a better result may be achieved for the aggregate of creditors in following an alternative course than rescuing the company as a going concern, the administrator remains with

⁷⁷⁷ Fletcher (2004) at 137.

⁷⁷⁸ Where the business is to be sold as a going concern, protective mechanisms in the form of the TUPE (Transfer of Undertakings (Protection of Employment) Regulations would find application. Therefore it may be incorrect to argue that the sale of a business of the company would, of necessity, prejudice employees more than any other category of unsecured creditor.

⁷⁷⁹ Schedule B1 at para 3; see further The Explanatory Note to the Enterprise Act, 2002, Chapter 40 at para 647.

⁷⁸⁰ The purpose of the administration would be to seek to ensure a distribution to secured and preferential creditors in line with their security interests. See further Keay and Walton (2008) at 95.

⁷⁸¹ Keay and Walton (2008) at 95. See further Katz and Mumford's *Study of Administration Cases* available at <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/studyofadmindocs.pdf> accessed on 23 September 2015.

ultimate discretion to determine what he/she considers to be achievable.⁷⁸² Notwithstanding this discretion, the administrator remains constrained to perform his/her functions in the interest of creditors as a whole.⁷⁸³

The U.K. Insolvency Act provides the administrator with flexibility to manoeuvre between objectives where this is justified. What is also pre-eminent is the premium placed on the desire to derive the best outcome for the company's creditors whether this is in the form of an actual company rescue or a sale of its business as a going concern.⁷⁸⁴

5.2.3. COMMENCEMENT AND APPOINTMENT

Administration proceedings commence once an administrator has been appointed.⁷⁸⁵ The company remains in administration for the period in which the appointment persists.⁷⁸⁶ It is for this reason that a discussion into the appointment of the administrator is entered into at this stage; it is inextricably linked to the commencement of proceedings. A discussion of commencement through both the out of court and application procedures follows.

5.2.3.1 OUT OF COURT PROCEDURE

An administrator may be appointed 'out of court' by a holder of a floating charge over the assets of the company.⁷⁸⁷ The Act describes a 'floating charge' in the following manner:

- ...(2) For the purposes of sub-paragraph (1) a floating charge qualifies if created by an instrument which—
 - (a) states that the paragraph applies to the floating charge,
 - (b) purports to empower the holder of the holding charge to appoint an administrator of the company,

⁷⁸² Paragraphs 3(1)(b) and 3(3). Loubser (2010) at 181 argues, correctly, that the choice of which objective to pursue in an administration rests solely with the administrator and that the courts are want to interfere in the absence of irrationality or bad faith. Frisby (2004) at 263 is of the view that this proviso reverses what may have been perceived as a shift towards a debtor-friendly system of insolvency in the Act, thus affirming the traditional form of a creditor-focused rescue regime. See Fletcher (2004) at 136.

⁷⁸³ As observed above, this may not be a positive obligation in all circumstances. See further Vanessa Finch 'Control and co-ordination in corporate rescue' (2005) 25 *Legal Stud* 374 at 378 who argues that the effect of the responsibilities imposed on the administrator is that he/she is not required to rescue the company at all costs.

⁷⁸⁴ McComack (2008) puts forward a similar view at pages 3 and 13.

⁷⁸⁵ The Insolvency Act defines an 'administrator' as '...a person appointed under [Schedule B1] to manage the company's affairs, business and property.'

⁷⁸⁶ Schedule B1 at para 1(2)(a) & (b). There are however exceptions, see para 1(2)(d) of the same schedule.

⁷⁸⁷ Schedule B1 Insolvency Act of 1986 at para 14. See Fletcher (2004) at 122.

- (c) purports to empower the holder of the floating charge to make an appointment which would be the appointment of an administrative receiver within the meaning given by section 29(2), or
- (d) purports to empower the holder of a floating charge in Scotland to appoint a receiver who on appointment would be an administrative receiver...⁷⁸⁸

Where an administrator has not been appointed by a floating charge holder⁷⁸⁹, appointment may be made by the company⁷⁹⁰ or by its directors.⁷⁹¹ Where appointment is made⁷⁹² by directors or the company, notice of the proposed appointment must be given to a qualifying floating charge holder within a period of at least five business days (if there is an existing floating charge holder).⁷⁹³ The floating charge holder has the first preference in relation to the administrator to be appointed. This veto with respect to an appointment may be explained on the basis of political compromise.⁷⁹⁴ The notice of intention to appoint must state the identity of the proposed administrator as well as be in the prescribed form.⁷⁹⁵

Once an appointment is made, a notice of appointment must be filed at court. Keay⁷⁹⁶ posits a possible reason as to why documentation relating to the out of court appointment must be filed, even if the substantive appointment for material purposes occurs outside the court:

Administration only commences once a notice of appointment has been filed...Why filing in the court is required is not clear...The more likely primary reason is to ensure that administrators appointed out of court can be recognised as officers of the court and, therefore, they are covered by the European Union Regulation on Insolvency Proceedings 2000, which is having a marked effect

⁷⁸⁸ Schedule B1 at para 14(2).

⁷⁸⁹ Schedule B1 at para 14.

⁷⁹⁰ Schedule B1 at para 22(1) through a resolution by its shareholders.

⁷⁹¹ Schedule B1 at para 22(2). Whether made by the company or its directors, a declaration by the appointing party must state that the company is or unlikely to be able to pay its debt, see paras 26 & 27. This requirement is identical to that seen in para 11(a) regulating appointment through court application.

⁷⁹² A distinguishing feature between the U.K. approach to its South African counterpart is that even though Schedule B1 allows for an out of court procedure for appointment of the administrator and commencement of proceedings, proceedings legally come into effect only once they have received court assent. The process may occur either through what may be perceived as procedural rubber-stamping by the court, whether initiated via company shareholder resolution, director decision or floating charge holder appointment. In this instance filing at court is a necessary precondition. The alternative is through substantive application to court. In both instances the same purpose is achieved and in both, the court is required to provide its endorsement. In this way proceedings are, to a degree, court-orientated notwithstanding the impression often created of distinct entry routes to the procedure.

⁷⁹³ Schedule B1 at paras 22 & 26. The preference of the floating charge holder in relation to the appointment is given priority. See Schedule B1 at para 36(2).

⁷⁹⁴ See Fletcher (2004) at 129.

⁷⁹⁵ Schedule B1 at para 26(3). The applicable form is Form 2.8B.

⁷⁹⁶ Andrew Keay 'A Comparative Analysis of Administration Regimes in Australia and the United Kingdom' in Paul J. Omar (ed) (2008) *International Insolvency Law: Themes and Perspectives* United States: Ashgate.

on insolvency law and practice in the United Kingdom. Unless a court is involved in some way, a procedure cannot be covered by EU Regulation.⁷⁹⁷

Within the context of director or company appointments, notice must be accompanied by the company resolution or directors' decision.⁷⁹⁸ The proposed administrator's consent to the appointment, a statement to the effect that in his/her view the purpose of administration is likely to be achieved as well as details of any previous professional relationship with the company, must be annexed to the notice.⁷⁹⁹

Appointment by the company or its directors must be made no later than ten days of the notice of intention to make an appointment having been filed at court.⁸⁰⁰ It is submitted that in light of the documentary requirements in paragraph 29(3) requiring an administrator to be identified as well as make declarations (in addition to consenting to the appointment), an appointment will be incompetent where there is failure to comply. This means that paragraph 31 will not have been complied with and the appointment will not legally have taken effect.⁸⁰¹

Keay and Walton argue that because appointment essentially occurs once the notice of appointment is filed with the court in terms of paragraph 31⁸⁰² the appointer must inform the prospective administrator soon after filing.⁸⁰³ The newly appointed administrator must in turn notify the company, its creditors and the registrar of companies of the appointment as well as publish the appointment in the government gazette.⁸⁰⁴

An appointment by the company or its directors may not be made if the company has been subject to administration within the immediately preceding twelve-months (whether in terms of paragraph 22 or through court application by the

⁷⁹⁷ Keay (2008) at 115

⁷⁹⁸ Where appointment is to be made by the company's directors, see Insolvency Rule 2.22 read with 2.25. It would also seem that the majority required for this purpose is a simple rather than a special majority. See Schedule B1 at para 105.

⁷⁹⁹ Insolvency Act 1986 Schedule B1 at para 29(3) and Rule 2.3(5) of the Insolvency Rules.

⁸⁰⁰ See Schedule B1 at paras 22 & 28(2).

⁸⁰¹ By implication, administration proceedings will be deemed to not have commenced. On an analysis of these provisions it would seem that the Insolvency Act contains both a requirement in relation to timeline as well as one relating to procedural compliance from a substantive perspective. This is possibly aimed at ensuring that the process is initiated expeditiously and that the administrator has opportunity to apply his/her mind to the circumstances surrounding the company.

⁸⁰² Which requires compliance with the notice requirements enumerated in para 29. This is a requirement in terms of para 32. Should such person fail to do so without reasonable excuse, such action attracts criminal penalty.

⁸⁰³ Keay and Walton (2008) at 106.

⁸⁰⁴ Schedule B1 at para 46 & Insolvency Rule 2.27.

company or its directors)⁸⁰⁵, where it has received the benefit of a moratorium in terms of a company voluntary arrangement and such arrangement ended prematurely⁸⁰⁶, where a winding up petition has been presented and not disposed or where an administrative receiver has assumed office.⁸⁰⁷

This is an important control mechanism for ensuring that administration proceedings are not entered into by the company simply to (i) benefit from the temporary moratorium against creditor claims or to (ii) unduly alter or reject pre-existing contractual obligations. Initiation by court procedure is discussed next.

5.2.3.2 COURT APPLICATION PROCEDURE

As briefly discussed, proceedings may alternatively be commenced through a substantive application to court. For this to occur, two requirements must be satisfied. It must be shown that the company is either unable to pay its debts or unlikely to be able to do so.⁸⁰⁸ In addition, it must be shown that the administration order will achieve the purposes of administration in terms of the Act.⁸⁰⁹

Paragraph 11(b) requires that it must be ‘reasonably likely’ that the purpose of administration will be achieved.⁸¹⁰ In *Auto Management Services Ltd*⁸¹¹ the court interpreted this phrase to require that a reasonable prospect of a better result in administration be achieved.⁸¹² Two tests generally find application in determining whether a company is unable to pay its debts.⁸¹³ These are the cash flow and balance

⁸⁰⁵ Schedule B1 at para 23(2). Loubser (2010) at footnote 72 argues that this is an important measure for preventing frivolous or filings in bad faith. She correctly observes that this aspect has been omitted in our company legislation. The court in *Lazenby v Lazenby Vervoer and Others supra* has attempted to curb potential abuse and re-filings in bad faith.

⁸⁰⁶ Schedule B1 at para 24.

⁸⁰⁷ Schedule B1 at para 25.

⁸⁰⁸ Paragraph 11(a). Similar requirements relating to insolvency are applicable in relation to ‘out of court’ appointments by the company or its directors, see para 27(2). In terms of an appointment by a floating charge holder the only requirement is that the floating charge be enforceable, see para 16 read with para 35(2). Therefore there is no requirement that the threshold of insolvency be met whereas a purported appointment by the company and its directors requires a declaration to the effect that the company is either unable to or unlikely to be able to pay its debts, see Schedule B1 Insolvency Act of 1986 para 27(2). Loubser (2010) observes this aspect at 177. For further reading see Fletcher (1996) at 422.

⁸⁰⁹ See para 11(b). The purpose of administration is discussed in greater detail earlier in the chapter.

⁸¹⁰ Insolvency Act 1986.

⁸¹¹ *Auto Management Services Ltd v Oracle Fleet UK Ltd* [2008] B.C.C.761 at 762.

⁸¹² *Auto Management Services supra* at 762.

⁸¹³ As observed, these do not apply where an application for appointment of the administrator is made by a floating charge holder in terms of para 35.

sheet tests.⁸¹⁴ In terms of the cash-flow test, the enquiry is whether the debtor company is able to pay debts as it carries on business.⁸¹⁵ The balance sheet test considers the extent to which a company's liabilities exceed its assets resulting in an inability to discharge debt.⁸¹⁶

A statutory demand for the payment of a debt exceeding 750 pounds by a creditor, which is served upon the debtor and remains unpaid for a period exceeding three weeks from date of service, is sufficient for the purposes of establishing an inability to pay.⁸¹⁷ From the case law it appears that where an application for administration is made, a court must be satisfied regarding the *probability* of the company not being able to satisfy its debts as opposed to a mere prospect of this occurring.⁸¹⁸

The court in *Re Colt Telecom*⁸¹⁹ has shed some insights regarding the applicable test. Finding against the petitioners, the court made a number of observations. It was held that the requirement in terms of section 123 of the Insolvency Act of 1986 was that the court be 'satisfied' that the company 'is or is likely to become unable to pay its debts'. This envisaged that both cash flow and balance sheet insolvency be proven to the satisfaction of the court.⁸²⁰ The court observed further that it was for the petitioner to prove the allegations made in the petition for administration.⁸²¹

⁸¹⁴ Keay and Walton (2008) at 16. See further R M Goode *Principles of Corporate Insolvency Law* (3rd ed) (2005) Sweet & Maxwell at 86-87; John M Wood 'Defining corporate failure: addressing the 'financial distress' concept: Part 1' (2014) 27(3) *Insolvency Intelligence* 38-40; John M Wood 'Defining corporate failure: addressing the "financial distress" concept: Part 2' (2014) 27(4) *Insolvency Intelligence* 56-58.

⁸¹⁵ Insolvency Act 1986 Schedule B1 at para 111(1) read with section 123(1).

⁸¹⁶ Insolvency Act 1986 Schedule B1 at para 111(1) read with section 123(2). In determining this aspect, both prospective and contingent liabilities are to be taken into consideration. These twin tests mirror those in the South African Companies Act for the purposes of determining whether a financially distressed company is able to have recourse to business rescue proceedings. Within the South African context there is some uncertainty regarding whether actual as opposed to prospective balance-sheet and cash flow insolvency will enable the company to have recourse to proceedings. The tentative view seems to be that business rescue is not suited to factually insolvent or 'terminally ill' entities. However, see discussion in Chapter 4 where it has been argued that from a practical perspective, no proper controls for determining the degree of insolvency currently exist within the context of a section 129 commencement.

⁸¹⁷ See section 123(1)(a) of the Insolvency Act 1986. This is in addition to five other grounds on which an inability to pay debts may be established.

⁸¹⁸ See *Cheyne Finance plc (No. 2) infra* at para 74.

⁸¹⁹ *Re COLT Telecom Group Plc* (No 2) [2002] EWHC 2815 (Ch).

⁸²⁰ *Re Colt Telecom Group supra* at para 34.

⁸²¹ *Re Colt Telecom Group supra* at para 42, 52 and 53.

In *Re Cheyne Finance plc (No.2)*⁸²² the court found that the balance sheet test in section 123 of the Insolvency Act was not precluded simply because the company was cash-flow positive. It interpreted the section to mean that both the cash-flow and balance sheet tests were to be seen as part of a singular exercise; this being the determination of a company's ability to pay its debts. Briggs J held that the cash-flow component of the test in s 123(1)(e) incorporated 'key words of futurity' in the form of the phrase 'as they fall due'.⁸²³ As a result, the view of the court was that the Insolvency Act entailed a flexible and fact-sensitive injunction to consider the company's future liabilities.⁸²⁴

This approach was confirmed by the Court of Appeal in *Eurosail*⁸²⁵. The court found that in construing the test for section 123(1)(e), debts falling due in the reasonably near future had to be taken into consideration.⁸²⁶ The court, however, accepted that where a liability was distant it would be difficult to deem a company insolvent where it was paying its debts as they fell due. It was further held that in relation to section 123(2), the enquiry included an analysis of the company's current assets, as well as its future liabilities while accounting for any contingencies or deferments.⁸²⁷ The court adopted the approach seen in the earlier *In re Telecom* matter in relation to onus.⁸²⁸

Even though the English courts have provided insight and content to applicable tests, some uncertainty remains. A reading of the first part of paragraph 11(a) with the definition of 'unable to pay debts' in section 123(1) of Insolvency Act highlights that a company is insolvent where it is unable to pay its debts as they fall due.⁸²⁹ The U.K. courts have further expanded upon this to include an inability to pay

⁸²² *In re Cheyne Finance plc (No. 2)* [2007] EWHC 2402 (Ch); [2008] 2 ALL E.R. 987; [2008] Bus. L.R. 1562.

⁸²³ *In re Cheyne Finance plc (No. 2)* at para 53.

⁸²⁴ *In re Cheyne Finance plc (No. 2)* at paras 34, 51-54.

⁸²⁵ *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc* [2013] UKSC 28; [2013] 1 W.L.R. 1408 (SC).

⁸²⁶ *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc supra* at para 37. The court observed that an inquiry into the 'reasonably near future' would in turn depend on (i) the circumstances as well as (ii) the nature of the company's business. The court cautioned that an enquiry which goes beyond this test will be purely speculative.

⁸²⁷ *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc supra* at para 37. For a brief commentary, see John M Wood 'BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc: from the point of no return to crystal ball gazing' (2014) 26(8) *Insolvency Intelligence* 124-127. See further *Casa Estates (UK) Ltd (In Liquidation), Re* [2014] EWCA Civ 383; [2014] B.C.C. 269 (CA (Civ Div)). See further, *Re AA Mutual Insurance Co. Ltd, Re* [2004] EWHC 2430 (Ch); [2004] WL 2577110.

⁸²⁸ *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc* at para 37.

⁸²⁹ See Schedule B1 at para 111(1).

debts as they fall due in future.⁸³⁰ While the section 123(1) determines present insolvency through its deeming provisions, it is the question of future probability (captured in the phrase ‘or is likely to become’⁸³¹) and how this is to be determined from a temporal aspect, which has not been given strong clarification.⁸³² Notwithstanding these observations, a debtor is able to have recourse to administration even in instances where it is currently able to pay its debts as they fall due (i.e. is cash-solvent), preventing an instance of waiting until it is effectively too late to rescue the company.

The court may be approached by the company’s creditors⁸³³, directors⁸³⁴, an officer so designated in terms of the Magistrates Courts Act⁸³⁵, the company or by the company liquidator.⁸³⁶ Different rules regulate persons required to draft the affidavit in support of the court application for administration.⁸³⁷ Where the application is made by the company or its directors, the affidavit may be drafted by either one of the directors or by the company’s secretary.⁸³⁸ Where made by the company’s creditors, they may delegate the power to draft to either one of them or to a third party.⁸³⁹ Attached to the application will be the proposed administrator’s written statement.⁸⁴⁰ Once filed and presented to the court, the application may not be withdrawn without permission.⁸⁴¹

⁸³⁰ Which would include an analysis of *inter alia* contingent debt. See cases discussed above.

⁸³¹ Schedule B1 at para 11(a).

⁸³² Although not without its own challenges, it may be argued that the South African approach is more exact, requiring probability of financial distress occurring within a six month period. See section 131(4)(a) read with the definition of ‘financial distress’ in section 128 of the Companies Act of 2008 in Chapter 4.

⁸³³ Schedule B1 at para 12(1)(c) & (4). This includes a contingent or prospective creditor if able to show that it has a ‘good arguable case’; see *Hammonds vs Pro-fit USA Ltd* [2007] All ER (D) 109 at para 53. Loubser (2010) at footnote 81 remarks that in the absence of exceptional circumstances, the court will not make an order on the basis of a disputed claim.

⁸³⁴ By majority, see para 12(1)(b) read with para 105 of the Insolvency Act of 1986.

⁸³⁵ See Schedule B1 at para 12(1)(d) and Section 87A of the Magistrates Court Act 1980 (c 43).

⁸³⁶ In terms of Schedule B1 paras 38(1) and 12(1)(a). See McComack (2008) at 58, 122. In such instance an applicant (where not a qualifying floating charge holder making application in terms of paragraph 35) must declare via supporting affidavit, that the company is unable to pay its debts and is unlikely to be able to do so. It must further furnish a statement regarding assets and liabilities of the company as well as any security held by creditors. See Rule 2.4(2)(a)-(c). The content of the affidavit by a floating charge holder making an appointment in terms of para 35 is regulated by Rule 2.4 (3).

⁸³⁷ The affidavit is referred to as a ‘witness statement’. Both terms are used interchangeably in the thesis.

⁸³⁸ Rule 2.2(2) of the Insolvency Rules. Such person must state on whose behalf the statement is made.

⁸³⁹ Rule 2.2(3) of the Insolvency Rules.

⁸⁴⁰ As required by Rule 2.3(5) of the Insolvency Rules.

⁸⁴¹ Schedule B1 at para 12(3).

The applicant must provide notice of the application at least five business days prior to the date of the hearing.⁸⁴² Parties who are entitled to notice include the proposed administrator, the company (if it is not the applicant), where there is a pending winding-up the petitioner, the provisional liquidator (where applicable), a qualifying floating charge holder⁸⁴³ and a supervisor of a voluntary arrangement, if any.⁸⁴⁴ The court has wide powers in relation to the application. These include granting, dismissing or adjourning proceedings. In addition, it may make any further order it deems appropriate.⁸⁴⁵ As a disincentive for instituting proceeding too late, the Insolvency Act⁸⁴⁶ imposes liabilities on directors for wrongful trading.⁸⁴⁷

⁸⁴² Schedule B1 at para 12(2) and Rule 2.8(1) of the Insolvency Rules.

⁸⁴³ Who may substitute the applicants proposed appointment for his/her own in terms of para 36. See further McComack (2008) at 122.

⁸⁴⁴ Schedule B1 at para 12(2). Rule 2.12(1) further provides a list of persons who may appear or be represented at the hearing of the application. Persons ordinarily not entitled to be heard may request permission from court if they are able to show that they have an interest in the matter. See Rule 2.12(1)(k). This aspect is also observed by Loubser (2010) at 188.

⁸⁴⁵ Schedule B1 at para 13(a)-(d) & (f).

⁸⁴⁶ Insolvency Act 1986, section 214.

⁸⁴⁷ This is starkly similar to the interplay between Chapter 6 of the South African Companies Act 2008 and its reckless trading provisions in section 22.

5.2.4. MANAGEMENT CONTROL

Upon appointment, there is a complete divestiture of management-control in favour of the administrator who will act as the representative of the company to the exclusion of its existing management.⁸⁴⁸ Existing directors may continue to exercise their functions where the administrator consents. The ultimate responsibility for the company, however, resides with the latter and he/she is as such vested with the power of removal.⁸⁴⁹

An insolvency practitioner⁸⁵⁰, in order to qualify as such, must be a member of a recognised professional body⁸⁵¹ or must have been given the authority by a competent authority to so act.⁸⁵² Despite meeting these conditions, an individual may not act as a practitioner where he/she is disqualified from acting as a director of a company⁸⁵³, remains an un-rehabilitated insolvent⁸⁵⁴ or suffers from a mental incapacity or illness.⁸⁵⁵

⁸⁴⁸ Schedule B1 at para 64. For a more comprehensive discussion of this aspect as well as the theoretical justifications for it, see Brian Cheffins and David A Skeel Jr 'Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom' (2002) 55 *Vanderbilt Law Review* 1699.

⁸⁴⁹ See Schedule B1 at paras 61 & 64. Unlike in the U.S. and the seemingly growing trend in South Africa, U.K. administrators are predominantly accountants rather than lawyers. See Rajak in Paul J. Omar *International Insolvency Law supra* who makes similar observations. McComack (2008) at 127 draws a link between the U.K. administration regime's greater emphasis on assets sales rather than reorganisations of corporate structures (which are more prevalent in the U.S.) and the trend of accountants being appointed as administrators:

'Having an accountant at the helm makes sense if the process is really about valuation and asset sales, rather than running the business with a view to bringing about the return of profitable trading.'

⁸⁵⁰ Section 388(1) of the Insolvency Act 1986 defines an 'insolvency practitioner' as a person, who in relation to a company is its liquidator, provisional liquidator, administrator or administrative receiver. It also includes a nominee or supervisor where a voluntary arrangement in relation to a company is proposed or approved. The thesis applies the terms 'insolvency practitioner' and 'administrator' interchangeably even though the former term is broader in the categories of persons it encompasses.

⁸⁵¹ And must be permitted to act as an insolvency practitioner in terms of its rules. See Insolvency Act 1986 section 390(2)(a).

⁸⁵² Insolvency Act 1986 sections 390(2)(a) and (b). The authorisation may be granted by the Secretary of State who has the power of delegation to another person or body, see section 392(2). The provisions relating to revocation of authorisation are stipulated in section 393.

⁸⁵³ This aspect is regulated by the Company Directors Disqualification Act 1986 sections 1- 6.

⁸⁵⁴ Schedule B1 at para 390(4)(a) refers to an 'undischarged bankrupt'.

⁸⁵⁵ Insolvency Act 1986, section 390. In addition, an administrator may be removed from office on a number of grounds; see Schedule B1 at paras 87-97. It is to be observed that the U.K. Insolvency Act 1986, through its Regulations, contains significantly more controls in relation to the regulation of the profession of insolvency practitioners and by inference, administrators. A consideration of some of the control mechanisms in the U.K. Act would go a long way towards resolving some of the concerns raised in relation to the South African business rescue regime in Chapter 4.

Further controls are imposed by the Insolvency Regulations⁸⁵⁶ which enable an authorising body to assess whether an applicant-practitioner, whilst having acted as an insolvency practitioner, failed to disclose circumstances giving rise to actual or perceived conflict of interest or an instance of personal financial gain, amongst other factors.⁸⁵⁷ In order to streamline the required competencies of insolvency practitioners (whether they be members of professional bodies or not), it is a requirement that a practitioner must have passed the examinations set by the Joint Insolvency Examination Board.⁸⁵⁸

The Insolvency Act vests the administrator with similar powers to a liquidator in relation to setting aside undervalued transactions, undue preferences, floating charges and extortionate credit bargains.⁸⁵⁹ The administrator may approach the court for recourse where the property of the company or to which the company is entitled is in the possession of a third party.⁸⁶⁰ In addition to the power to confirm or cancel certain transactions⁸⁶¹, the administrator is vested with fiduciary duties and is expected to act in good faith.⁸⁶²

⁸⁵⁶ Insolvency Practitioners Regulations of 2005.

⁸⁵⁷ The Regulations further provide for the factors to be considered for insolvency practitioners entering the field, in terms of practical education, experience or combined hours spent on insolvency related work. For example, see Regulation 7(1) to (6) and Regulation 8.

⁸⁵⁸ Loubser (2010) at 199.

⁸⁵⁹ Insolvency Act of 1986, sections 238, 239, 244 and 245. It is difficult to understand why the South African business rescue practitioner in terms of the new Act is not vested with similar, clearly defined powers seen in the previous judicial management regime.

⁸⁶⁰ Insolvency Act 1986, section 234.

⁸⁶¹ It is submitted that this is not the same as the power to suspend or cancel contracts seen in the South African counterpart. Interestingly, the South African Companies Act does not have a clear statutory framework allowing the practitioner to set aside pre-commencement transactions which have the effect of prejudicing the general body of creditors (as seen with the previous judicial management regime). In contrast, the Bankruptcy Code allows for acceptance or rejection of contracts as well as the setting aside of certain transactions. Despite a lack of clear articulation of the administrator's powers to cancel contractual agreements (excluding employment contracts) in the Insolvency Act, there is, however, no reason to believe that the administrator would be barred from invoking his/her broad powers in terms of the Act or requesting directions on the exercise of his/her powers from the courts.

⁸⁶² Schedule B1 at para 5. The Insolvency Act of 1986 has ensured that the administrator, in addition to having to act in good faith, has an underlying duty to act in the interests of the company's creditors as a whole, see para 3(2). Regrettably, apart from fiduciary duties towards the company there is no commensurate duty on the business rescue practitioner imposed by Chapter 6. See *Re Charnley Davies Ltd (No.2)* [1990] BCLC 760; [1990] BCC 605. In relation to the administrator's power in with respect to contracts, see further Professor R.M Goode *Principles of Corporate Insolvency Law* (1990) London, Sweet and Maxwell at 129.

Frisby argues that the only real innovation in relation to the powers conferred upon the administrator in terms of the Enterprise Act 2002 is that he/she may make distributions to preferent and secured creditors without seeking leave from court.⁸⁶³

It may be argued that the observations made by Frisby do not give much credence to the often indirect powers granted by the Insolvency Act to administrators in achieving the purposes of administration.⁸⁶⁴ Controls are placed on the manner in which these duties are performed, with many of these having developed through the common law.⁸⁶⁵

From a procedural perspective, the fiduciary duty towards creditors ensures that the wide powers vested upon the administrator are exercised in a manner that, at minimum, seeks to maximise the financial welfare of the debtor and its creditors.⁸⁶⁶ This further ensures that during proceedings and in seeking to achieve any of the three purposes of administration, the appointed administrator remains cognisant of the competing rights which may be affected by his/her proposed course of action. In contrast to chapter 11 which is analysed later, the interests of creditors are placed squarely on the shoulders of the administrator, with no right on the part of creditors to propose alternative plans.

5.2.5. MORATORIUM ON PROCEEDINGS

The moratorium is arguably the most distinctive feature of administration. It allows the company to enjoy some relief from its creditors while attempting to restructure its affairs.⁸⁶⁷ The effect of the moratorium is to bar enforcement proceedings against the company or its property in the absence of consent.⁸⁶⁸

Due to the prejudicial effect that a moratorium has on creditors' enforcement rights, a creditor catching wind of the prospect of administration proceedings may

⁸⁶³ Frisby (2004) at 262. She observes, correctly, that leave of court is required in terms of para 65 (3) where a distribution is proposed contrary to the provisions of that paragraph, being a distribution to unsecured creditors in preference to both secured and preferent creditors.

⁸⁶⁴ Reference has been made above to the legislation's drafting style which caters for the administrator's use of subjective intention and discretion as to which objective to choose as well as how best to execute it; See Daniel Prentice 'Bargaining in the Shadow of the Enterprise Act 2002' (2004) 5 *European Business Organization Law Review* 153 at 158.

⁸⁶⁵ See the *Re Charnley Davies and Re Home Treat Ltd* cases cited above.

⁸⁶⁶ The powers of the administrator are listed in para 59 of Schedule B1 and Schedule 1 of the Insolvency Act of 1986. The conduct of an administrator may be impugned in terms of para 74 of Schedule B1 in the case of unfair conduct which prejudices an affected party and para 75(3) where misfeasance or breach of fiduciary against the company is alleged.

⁸⁶⁷ Key and Walton (2008) at 106.

⁸⁶⁸ Whether consent is received from the administrator or the court. Schedule B1 Paragraphs 42 and 43. See Key and Walton (2008) at 107.

naturally wish to enforce its rights against the debtor company as soon as possible. It is for this reason that the moratorium presents itself in two forms: the interim and final moratoria. Unlike the ‘old’ Insolvency Act 1986⁸⁶⁹ the final moratorium comes into effect only once the administrator’s appointment has received court sanction.⁸⁷⁰ In order to curb a potential flurry of creditors seeking legal recourse against the company prior to the formal commencement of proceedings, the Act allows for the operation of an interim moratorium.

The interim moratorium operates in a number of cases. It comes into effect when an application for administration is filed at court and continues until the application is granted or dismissed.⁸⁷¹ It applies from the moment a notice of intention to appoint an administrator has been filed until the appointment occurs or ten days elapse without the appointment having taken place.⁸⁷² Where an appointment is proposed in terms of paragraph 14, the actual appointment should occur within five days after the notice of intention to appoint has been filed.⁸⁷³ During this period, directors remain in control of the company and are in a position to use, encumber and dispose the company’s assets at will despite the court’s powers to restrict the exercise of this power.⁸⁷⁴

The final moratorium comes into force once appointment of the administrator has occurred. While the final moratorium is in force, petitions for the winding up of the company may not be made.⁸⁷⁵ Where consent is granted for legal process to

⁸⁶⁹ Prior to its amendment by the Enterprise Act 2002.

⁸⁷⁰ Loubser (2010) at 192. Section 10 of the Insolvency Act 1986 prior to its amendment provided for the application of an automatic moratorium once the decision to place the company in administration was filed at court.

⁸⁷¹ Schedule B1 at para 44(1).

⁸⁷² Schedule B1 at paras 44(4). The ten day appointment period applies where the proposed appointment is by the company or its directors as per para 28(2).

⁸⁷³ Paragraph 44(2). The interim moratorium comes into force once the notice of intention to appoint has been filed. It is observed that a similar situation prevails within the context of applications for business rescue through court. This aspect is discussed in the previous chapter.

⁸⁷⁴ See para 13(3)(a) which commentators such as Loubser (2010) at 194 view as largely ineffective in instances where the application is in on unopposed motion but notes the potentially deterring effect for delinquent or wrongful behaviour of legislation such as the Company Director Disqualification Act 1986 (c46).

⁸⁷⁵ Schedule B1 at para 42. The same exceptions apply in relation to both the interim and final moratoria. These are exceptions on public interest grounds or where a European entity is in question. See section 12A of the Insolvency Act and s 367 of the Financial Services and Markets Act of 2000. Should there be breach of the moratorium, the consequences are well articulated by the court in *Euro Commercial Leasing Ltd v Cartwright & Lewis* [1995] BCC 830. The administrator is empowered to present a petition for the winding up of the company but would have to make application to court in terms of paragraph 79 for the termination of his/her appointment.

commence, it may be made subject to terms which the court deems fit.⁸⁷⁶ Arbitration proceedings (termed ‘quasi-legal proceedings’) in the U.K. are barred by the scope of the moratorium.⁸⁷⁷ This however does not include proceedings within the context of regulated industries.⁸⁷⁸

An owner’s right to repossession in a hire purchase agreement is prohibited in the absence of court sanction.⁸⁷⁹ Therefore, a property owner’s right to repossess his/her immovable property is prohibited except where such ‘peaceable re-entry’ is sanctioned by the administrator or the court.⁸⁸⁰

Parties may approach the court for the purpose of lifting the stay.⁸⁸¹ The Insolvency Act of 1986 and the development of case law in this area has ensured that courts are vested with discretion for the purposes of determining whether a creditor seeking to enforce its rights in an administration is able to do so. In many instances, the rights of a creditor to its property or the ability to enforce its claim against the debtor company must be weighed against the concept of collective creditor interest in the administration being a success.⁸⁸²

5.2.6. PROTECTION OF PROPERTY INTERESTS

The Insolvency Act provides for the protection of property interests. No action may affect the priority of secured and preferent creditors’ interests without the affected creditor’s consent.⁸⁸³ Should the administrator’s actions be contrary to the prescripts

⁸⁷⁶ Schedule B1 at para 43(6). The Insolvency Act distinguishes between ‘enforcement’ and ‘legal process’ (which includes ‘legal proceedings’). The moratorium provisions of the South African Companies Act make use of both terms and in a similar vein require either practitioner consent or court sanction, with exceptions.

⁸⁷⁷ *Bristol Airport v Powdrill* [1990] Ch 744 at 766 at para F. Keay and Walton (2008) at 110-111 argue that the moratorium in the older provisions (section 11(3)) had wider ambit and included an application by an employee to a tribunal under the Employment Rights Act 1996. They argue, correctly, that it is not entirely clear how the narrow phrase, ‘legal proceedings’ in the new provisions will be interpreted as the older provisions also referred to ‘other proceedings’. See *Carr v British International Helicopters Ltd* [1993] BCC 855.

⁸⁷⁸ See *Air Ecosse Ltd v Civil Aviation Authority* (1987) 3 BCC 492 at 495-6; *Re Railtrack plc* [2002] 1 WLR 3002.

⁸⁷⁹ Schedule B1 at para 43(3).

⁸⁸⁰ Schedule B1 at para 43(4).

⁸⁸¹ For further reading on the approach of the English Courts on this aspect see *Bristol Airport plc v Powdrill* [1990] Ch 744; *Re Atlantic Computer Systems plc (No. 1)* [1992] Ch 505 where the court provided an exposition of factors to be considered in the application of the previous section 11(3) of the Insolvency Act of 1986. See an article which provides a brief analysis of the judgment of Nicholls LJ by David Milman ‘Moratorium on Enforcement Rights: Revisiting Corporate Rescue’ (2004) *Conveyancer and Property Lawyer* March/April 89 at 99.

⁸⁸² See *Powdrill and Re Atlantic cases supra*.

⁸⁸³ Schedule B1 at para 73.

of the section, it may be challenged at court.⁸⁸⁴ Even though the administrator has powers of disposal on assets over which a floating charge holder has a security interest⁸⁸⁵, the interest will attach to proceeds of the sale as well as to further assets purchased with the proceeds.⁸⁸⁶

Where there is a fixed charge over property or where property is subject to hire purchase, the administrator must seek court approval and such approval may be granted if the court is satisfied that the disposal will promote the purpose of administration.⁸⁸⁷ Any deficit between the net realisable amount on disposal and the market value of the asset must be applied towards the amount secured by the fixed charge.⁸⁸⁸

5.2.7. PUBLISHING THE PLAN

The administrator must, within an eight-week period, send his/her statement of proposals on how he/she intends achieving the purposes of administration.⁸⁸⁹ The proposals must be circulated to the Registrar of Companies, to every known creditor and to members of the company.⁸⁹⁰

An initial meeting of creditors must be convened within at least ten weeks of commencement.⁸⁹¹ Proposals must contain the history of the company, its current financial position, its expected future plans and information necessary to enable a creditor to decide whether or not to support the proposed plan.⁸⁹² Information relating

⁸⁸⁴ See Keay and Walton (2008) at 115.

⁸⁸⁵ Schedule B1 at para 70.

⁸⁸⁶ Schedule B1 at para 70(2).

⁸⁸⁷ Schedule B1 at para 71 & 72.

⁸⁸⁸ This is to ensure that the holder of the floating charge is not left out of pocket by the disposal.

Schedule B1 at para 71 & 72. McComack (2008) at 197; *Re ARV Aviation Ltd* [1989] BCLC 664.

⁸⁸⁹ Schedule B1 at para 49(4) & (5) and Insolvency Rule 2.33.

⁸⁹⁰ Schedule B1 at para 49(4). The administrator may, however, publish a notice with instructions as to how the statement of proposals may be obtained. See Schedule B1 at para 49(6) read with Rule 2.33(7) & (7A).

⁸⁹¹ Schedule B1 at para 51(2) and see the exceptions to this listed in para 52(1). It must be emphasised that the initial meeting may be convened before this period as the Insolvency Act makes use of the term 'as soon as is reasonably practicable'. The proposals are to be presented at this meeting in terms of para 51(3). There is a further requirement that details of the meeting be gazetted in terms of Rule 2.34 or in any other manner the administrator deems appropriate; see Rule 2.34(1A).

⁸⁹² The administrator may obtain financial information by invoking the provisions of para 47 to 48 of Schedule B1. See McComack (2008) at 62.

to how the company has been managed since the administrator was appointed must be provided as well as information relating to future management and financing.⁸⁹³

Where the administrator believes that the company has sufficient property to extinguish its debts in full (i.e. is solvent) or where there is insufficient property to make distributions to unsecured creditors (apart from the ring-fencing provisions in section 176A of the Insolvency Act, 1986), the administrator may elect not to hold an initial creditors' meeting unless creditors holding at least 10% of the company's debt request him/her to do so.⁸⁹⁴

The administrator may sell certain categories of company assets without court or creditor approval if it can be shown that this is justified by the circumstances and will best further the objective of administration. It may include the sale of assets without convening a meeting of creditors to decide and vote upon proposals.⁸⁹⁵ The advantage of this approach is in expedited proceedings, certainty for the debtor

⁸⁹³ Insolvency Rule 2.33(2)(o). It would seem that this aspect is left largely to the practitioner in drafting the proposed plan of rescue in the Companies Act of 2008. Our provisions do not contain specific informational requirements in relation to the future management of the company. The latter may be covered in section 150(2)(b)(iii) requiring that any proposals include a statement as to the on-going role of the company.

⁸⁹⁴ The decision for such election must be contained in the statement. Schedule B1 at para 52(1) & (2). On the non-compulsory nature of initial creditors' meetings see McComack (2008) at 63; HL Debates 29 July 2002 at column 783 available at <http://www.parliament.uk/business/publications/hansard/lords/by-date/#session=27&year=2016&month=4&day=12> accessed on 8 December 2016.; Sandra Frisby 'Not Quite Warp Factor 2 Yet? The Enterprise Act and Corporate Insolvency' (2007) 22 *Butterworths Journal of International Banking and Financial Law* 327. The cost of the meeting shall be for the requesting creditors' account. The administrator may convene a meeting prior to or after the initial meeting in term para 62. It has been observed by some commentators that in practice, a single meeting of creditors during the administration process is the norm. See L Doyle and A Keay *Insolvency Legislation: Annotations and Commentary* 2 ed (2006) Bristol: Jordans Publishing at 92; Louise Gullifer 'The Reforms of the Enterprise Act 2002 and the Floating Charge as a Security Device' (2008) 46 *Canadian Business Law Journal* 399 at 407. Loubser (2010) at 207 observes that the administrator is not obliged to consult major creditors on any proposals involving significant action such as a sale of assets of the company. This view seems to find support in the exception listed in paras 52(1)(c) and 59 of Schedule B1.

⁸⁹⁵ Schedule B1 at para 52(1)(c). See the general powers vested upon the administrator in terms of para 59 as well as the administrator's powers of sale in terms of Schedule 1; *Re Transbus International Ltd (In Liquidation)* [2004] EW HC 932 (Ch), [2004] 2 All ER; *Re Charnley Davies supra*. This course of action has received sanction within the context of pre-packaged deals. For a more comprehensive discussion of pre-packs, see Keay and Walton (2008) at 125-130. See the Explanatory Note to the Enterprise Act 2002 at para 642. It may be argued that the prejudice observed by the commentators is illusory as a pre-pack may be said to meet the prescripts of para 3(1)(c), where an administrator may pursue the interests of secured or preferred creditors rather than the general body. For further readings see P Walton 'Pre-Packaged Administrations- Trick or Treat?' (2006) 19 *Insolvency Intelligence* 113; A Bloom and S Harris 'Pre-packaged administrations- what should be done given the current disquiet?' (2006) 19 *Insolvency Intelligence* 122; Vanessa Finch 'Pre-packaged Administrations: bargains in the shadow of insolvency or shadowy bargains' (2006) *Journal of Business Law* 568; On the cases, see *DKLL Solicitors v HM Revenue and Customs* [2007] EWHC 2067 (Ch); 2007 BCC 908 and *Transbus supra*.

company and its employees as well as respite from the stigma that attaches to a company by being in insolvency proceedings. Such flexibility may, however, create room for possible abuse.

The proposal may be in the form of a corporate voluntary arrangement⁸⁹⁶, a compromise through a scheme arrangement with members in terms of the Companies Act⁸⁹⁷ or through a pre-packaged sale of the company's business. A feature that makes administration a unique rescue mechanism is that it is designed as a gateway to other legally separate compromise mechanisms rather than a singular procedure as seen in the U.S. Bankruptcy Code⁸⁹⁸ or South African Chapter 6 proceedings.⁸⁹⁹

The company voluntary arrangement and the scheme of arrangement may be described as restructuring mechanisms which permit a compromise of company debt through assent by the majority of its creditors.⁹⁰⁰ Armour *et al* observe that due to these mechanisms facilitating financial restructuring, they may be categorised as rescue procedures and may exist independently of administration.⁹⁰¹

McComack observes that the company voluntary arrangement inclusive of a moratorium against claims is restricted to small companies on condition that their directors are able to provide evidence that the arrangement possesses reasonable prospects of succeeding and that there are sufficient funds in place for the purpose of continuing operations during the arrangement.⁹⁰² Schemes of arrangements are often employed for compulsory buy-outs of creditors in that where a 75% in value approve a proposed scheme, it is binding on both abstaining and dissenting creditors.⁹⁰³

Proposals require a simple majority of creditors by value present and voting, whether in person or by proxy, for approval.⁹⁰⁴ A secured creditor is entitled to vote to

⁸⁹⁶ See Schedule B1 at para 49(3)(a). The company voluntary arrangement mechanism is regulated in part 1 of the Insolvency Act, 1986.

⁸⁹⁷ Previously section 425 of the Companies Act 1985 now 895- 899 of the Companies Act of 2006.

⁸⁹⁸ Bankruptcy Reform Act of 1978.

⁸⁹⁹ Companies Act 71 of 2008. McComack (2008) emphasises this point throughout his analysis of the regime. See further similar observations made by Colin Anderson & David Morrison 'Commencement of Company Rescue: How and When does it Start' in Paul J. Omar *International Insolvency* op cit; Goode (2005) at 328.

⁹⁰⁰ Armour *et al* (2008) at 156. Provisions in relation to schemes of arrangement were contained in section 425 of the Companies Act 1985 (now section 895 of the Companies Act of 2006) while the company voluntary arrangement is regulated by Part 1 of the Insolvency Act 1986.

⁹⁰¹ Armour *et al* (2008) at 156.

⁹⁰² McComack (2008) at 65.

⁹⁰³ McComack (2008) at 66.

⁹⁰⁴ Insolvency Rule 2.43 & 2.38(4). Conversely, where 51% of independent creditors have voted against a resolution on a proposed plan such plan will have been rejected. See further Schedule B1 at paras 53 & 55.

the extent to which its security is insufficient to cover the entire debt.⁹⁰⁵ The Act further imposes limitations on the extent to which the ranking of preferences may be overridden.⁹⁰⁶ Once the initial creditors' meeting has concluded, the administrator must *inter alia* provide a report of any decision taken in such meeting to court.⁹⁰⁷

The administrator may propose further amendments after the proposals have received creditor approval. This will occur where the administrator considers the proposed amendments to be substantial and a meeting of creditors must be summoned for a vote.⁹⁰⁸ Where an amendment to the proposal is sought by creditors at both the initial and proposal revision meetings, it must receive the consent of the administrator.⁹⁰⁹ After the conclusion of the meeting to consider further amendments to the initial proposal, the administrator is further required to submit a report to court detailing the content of the meeting.⁹¹⁰ Where it is not possible to reach agreement regarding the inclusion of an amendment, the matter must be referred to court for resolution.⁹¹¹ The requirement of specific consent on the part of the administrator reflects the centrality of the discretion granted to the administrator by the Insolvency Act.

5.2.8. EXPENSES OF THE ADMINISTRATION/POST-COMMENCEMENT LIABILITY

The Insolvency Act allows for the prioritisation of certain qualifying expenses once a company has entered administration. The concept of an expense of the administration allows for the preference in payment of certain expenses, costs, and disbursements incurred at the pre and post-commencement stages.⁹¹² This ensures that the company functions long enough to enable the achievement of one or more of the objectives

⁹⁰⁵ Voting interest is determined by the value of the unsecured portion of the debt. Rule 2.40(1) read with para 73(1) & (2). However see the exception stated in Rule 2.40(2).

⁹⁰⁶ Schedule B1 at para 73(1)(a), (b) and (c) read with sub-section 2.

⁹⁰⁷ Schedule B1 at para 53(2)(a).

⁹⁰⁸ Schedule B1 at para 54(1) & (2). The phrase '...thinks that the proposed revision is substantial' infers that the administrator's subjective view is sufficient and that where his/her view is to the contrary, the provision need not be complied with. The administrator must in terms of sub-paragraph 6 communicate the result of the meeting to the court, Registrar of Companies and other prescribed persons.

⁹⁰⁹ Schedule B1 at paras 53(1)(b) & 54(5)(b).

⁹¹⁰ Schedule B1 at para 54(6)(a).

⁹¹¹ The court may uphold the administrator's view despite creditor protest and opposition. See Schedule B1 at para 55(2). See *Re Maxwell Communications Corp* [1992] B.C.C. 465 at 374; *Re Structures & Computers Ltd* [1998] BCC 348 at 353; *DKLL Solicitors supra* at para 18. The court is vested with the discretion in terms of the same paragraph to order that the proceedings come to an end.

⁹¹² Rules 2.67, 2.67A read with 2.33(2)(ka).

envisaged in paragraph 3 of the Insolvency Act. Provision for post-commencement liabilities incurred by the administrator reads:

- ...(3) The former administrator's remuneration and expenses shall be—
 - (a) charged on and payable out of property of which he had custody or control immediately before cessation, and
 - (b) payable in priority to any security to which paragraph 70 applies.
- (4) A sum payable in respect of a debt or liability arising out of a contract entered into by the former administrator or a predecessor before cessation shall be—
 - (a) charged on and payable out of property of which the former administrator had custody or control immediately before cessation and
 - (b) payable in priority to any charge arising under sub-paragraph (3)...⁹¹³

Pre-administration claims falling within this category include those incurred by the practitioner in the course of proceedings (necessary disbursements), expenses properly incurred, costs of any security provided as well as certain categories of unpaid expenses preceding administration.⁹¹⁴ The administrator's remuneration has a ranking stronger than that of a secured floating charge holder.⁹¹⁵

The Insolvency Act does not seem to contain provisions expressly providing for super-priority. The U.K. Government resisted attempts of introducing amendments that would have created a super-priority for post-commencement lenders.⁹¹⁶ Finch argues that the fact that the Enterprise Act of 2002 did not introduce priority financing during administration has meant that powerful lenders such as banks are able to use their leverage as a way of advancing their interests.⁹¹⁷ As post-commencement financing is essential for the success of any rescue intervention and in light of the seeming indifference displayed by the legislature on this aspect, the question of how post-commencement finance is catered for within administration deserves closer scrutiny.

⁹¹³ Schedule B1 at para 99.

⁹¹⁴ Insolvency Rule 2.67, 2.67A read with Rule 2.33(2)(ka). See *Re Trident Exeter City Council v Bairstow* [2007] BCC 236. It has been held that statutory redundancy payments to employees do not constitute an expense of the administration as they are not 'wages or salary' but rather statutory employment liabilities see *Re Allders Department Stores Ltd* [2005] B.C.C 289 at 295-5. However see the *dictum* of the court in *Gerald Morris Krasner (The Administrator of Globe Worsted Company Limited & Huddersfield Fine Worsteds Limited) v Mr McMath* 2005 WL 1767590 at paras 31 and 32 where it was held that payments in lieu of notice and protective employment awards payable in terms of section 189(3) of the Trade Union and Labour Relations Act ('TULR') of 1992, where the requirements of para 99(5)(b) were satisfied (i.e. upon adoption of the employment contract by the administrator), fell within the definition of 'wages or salary' in terms of para 99(6)(d).

⁹¹⁵ Schedule B1 at para 99(3)(b).

⁹¹⁶ See House of Lords Parliamentary debates for 29 July 2002; McComack (2008) at 195.

⁹¹⁷ Finch (2005) at 381.

Any contract entered into by the administrator, once proceedings have commenced, will rank in priority above both his/her remuneration and the floating charge holder's security interest.⁹¹⁸ This will include any contract relating to financing the rescue intervention and further credit advanced to the debtor. It has been observed that even though post-commencement creditors may not have a strictly enforceable 'expense of the administration' claim against the company, where the administrator refuses to pay these expenses, creditors may have a strong case for the enforcement of their rights in court.⁹¹⁹

In spite of the popular view that the administration procedure does not provide for super-priority, from an analysis of the *dictum* of the court in *Re Trident Exeter City Council* it may be inferred that liabilities falling within paragraph 99 are accorded a limited form of super-priority.⁹²⁰ Having regard to the Act's provisions and case law, legislators have been very careful to avoid creating super-priorities and have retained the preferences existing in insolvency law, should administration proceedings prove unsuccessful.⁹²¹ This has ensured that long established and time tested measures for dealing with creditor interests are not unduly affected where this can be avoided. The obvious advantage of this approach is in the form of market certainty.

⁹¹⁸ Schedule B1 at para 99(4). In *Centre Reinsurance International Co v Freakley* [2007] Bus LR 284 the court at para 16 interpreting the provision of the previous section 19 incorporated the requirement of specific approval from the administrator after administration has commenced. This judgment must be viewed in light of *Re Trident Exeter City Council v Bairstow* case *supra*, which deals with the current provisions.

⁹¹⁹ See Keay and Walton (2008) at 131.

⁹²⁰ *Re Trident Exeter City Council v Bairstow* at 255. I have deliberately used the term 'limited form' because unlike the position with post-commencement liabilities seen in section 135 of the Companies Act of 2008, whose priority ranking endures in a subsequent liquidation, the court in this case held a different view.

⁹²¹ *Re Trident Exeter City Council v Bairstow* at 255.

5.2.9. DISTRIBUTION TO CREDITORS

The distribution to creditors is determined in proposals prepared by the administrator. Because administration is a ‘gateway’ procedure with a number of different legal routes that an administrator may have recourse to in achieving the purposes in paragraph 3⁹²², the Insolvency Act provides guiding provisions.

While the administrator may make a distribution to creditors, he/she must ensure that the distribution is in line with the preferences stipulated in the Act.⁹²³ Paragraph 65 states that an administrator ‘may’ rather than ‘must’ make a distribution to creditors.⁹²⁴ This is in line with the Insolvency Act’s approach, vesting the administrator with discretion to determine the manner in which purposes of administration may best be met.⁹²⁵

Schedule B1 invokes the general provisions of section 175 of the Insolvency Act, providing priority for secured and preferent creditors over debenture and floating charge holder creditors. The result is that the first payment will go to expenses in administration, preferential claims, amounts which have been secured by floating charge and lastly, general unsecured creditors.⁹²⁶ As observed, deviation from this ranking in favour of unsecured creditors requires court sanction.⁹²⁷ Where the administrator is able to show that a payment contrary to the provisions of paragraph 65 of Schedule B1 will enable the achievement of the purpose of administration, he/she may deviate from the stipulated priorities.⁹²⁸

⁹²² Insolvency Act 1986.

⁹²³ Insolvency Act 1986, section 175.

⁹²⁴ Insolvency Act 1986.

⁹²⁵ Highlighted earlier in the chapter.

⁹²⁶ Section 175 and Rule 2.68 of the Insolvency Rules.

⁹²⁷ Schedule B1 at para 65(3).

⁹²⁸ Such deviation being necessary or incidental to the performance of his/her functions, see para 13 of Schedule 1 of the Insolvency Act 1986.

5.2.10. EMPLOYEE CREDITORS - IMPACT OF TUPE AND EMPLOYEES ACT

The treatment of employee creditors in insolvency is inextricably linked to the development of European Union ('EU') law. EU law has created minimum guidelines for employee engagement and provides a basis informing the manner in which employees are treated. The Charter of Fundamental Rights and the Acquired Rights Directive are of great importance.

The Charter of Fundamental Rights⁹²⁹ speaks to the employer's participatory and informational responsibilities while the Acquired Rights Directive⁹³⁰ finds application within the context of business transfers. The latter directive has been implemented in the provisions of TUPE.⁹³¹ The current TUPE regulations replaced the 1981 regulations. McMullen⁹³² highlights the process which led to the regulations coming into force in 2006:

The DTI issued an original consultation document in 2001 and then published certain aims that it wished to achieve, in a press release, on 14 February 2003. In March 2005 the DTI issued a consultation paper containing draft TUPE Regulations 2005 which were originally intended to come into force on 1 October 2005. Much delayed, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE 2006) were laid before Parliament on 7 February, published on the OPSI and DTI website on 15 February and came into force on 6 April 2006...⁹³³

The new TUPE Regulations introduced the following: (i) An expanded definition of TUPE inclusive of contracting out and business services in order to enhance certainty and reduce litigation and disputes, (ii) greater clarity on the effect of the Regulations within the context of dismissals occasioned by transfers as well as scope for employers to amend applicable conditions, (iii) a requirement that an existing employer provide information to a transferee employer on the identity of existing employees as well as the rights and liabilities transferable to the latter and

⁹²⁹ Charter of Fundamental Rights Chapter IV, Article 27.

⁹³⁰ Acquired Rights Directive EEC Council Directive 187 of 1977 as amended and consolidated in Directive 2001/23/EC.

⁹³¹ The Transfer of Undertakings (Protection of Employment) 2006 regulations 13 and 14. For further reading on this aspect, see sections 188 & 189 of the Trade Union and Labour Relations (Consolidation) Act 1992 as amended. On the failure of an employer to consult with representatives within the required timeline, see the tests devised by courts in *Susie Radin Ltd v GMB* [2004] 2 All ER as confirmed in *Sweetin v Coral Racing* [2005] WL 3749701252 at paras 30-36. A comprehensive discussion of this aspect is unfortunately beyond the scope of the thesis.

⁹³² John McMullen 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' (2006) Vol. 35 No. 2 *Industrial Law Journal* 113.

⁹³³ McMullen (2006) at 114.

(iv) concessions in terms of the regulations within the context of insolvent transfers.⁹³⁴

It is important to distinguish between employee salary and wage claims incurred prior to as well as after the administrator's assumption of office. In relation to the former category of claims, there seems to be a dearth of literature specifically and comprehensively covering this topic.⁹³⁵ From a reading of the Act, the following is observed: Paragraph 65(2), stipulating the manner in which distributions are to be made in administration, provides that the provisions of section 175 apply as if the debtor is being wound up. Section 175(1), the general provision in respect of preference in a winding up, in turn makes reference to Part XII of the Insolvency Act.⁹³⁶

Upon analysis, an employee has a preferential claim in respect of outstanding salaries for a period of four months before the date on which the company entered administration, with a maximum preferential claim of £ 800.⁹³⁷ It is observed that the U.K. approach, while making provision for preference in respect of pre-administration wage claims, caps this entitlement. Wage claims falling outside of preference will, if submitted, be subject to the administrator's proposals.

Where an administrator's proposal contemplates a sale of the business as a going concern, the provisions of TUPE in conjunction with the Employment Rights Act of 1996 find application. Within the context of transfer, regulation 8 of TUPE makes Part XII of the Employment Rights Act applicable to transactions where the transferor employer is not insolvent. In a transfer of business contemplated in terms of TUPE, regulation 8 deems the termination of employment requirement to have been satisfied for the purposes of the Employment Rights Act even if such termination has not occurred.⁹³⁸ Second and perhaps more significant, it makes the National Insurance

⁹³⁴ McMullen (2006) at 115. For a brief outline of some of the criticisms raised against the Acquired Rights Directive 2001 and the TUPE Regulations 2006, see John Armour and Simon Deakin 'Insolvency and employment protection: the mixed effects of the Acquired Rights Directive' (2003) 22 *International Review of Law and Economics* 443-463.

⁹³⁵ The same observation is made by Chrispas Nyombi 'Employees' rights during insolvency' (2013) 55(6) *International Journal of Law and Management* 417. In many of the articles read, the position often put forward is that where wage claims are found to fall outside of para 99 of Schedule B1, they will simply constitute unsecured claims, without specific analysis and enquiry into the possibility or extent (if any) of pre-administration wage preference.

⁹³⁶ Specifically section 386 which regulates categories of preferential debt and makes further reference to category listing in Schedule 6.

⁹³⁷ See Schedule 6, Category 5 at para 9 read with the definition of 'relevant date' in section 387(1) & (2)(a).

⁹³⁸ See regulation 8(3) & (4) read with section 182(a) & (b).

Fund party to the transaction in respect of wages which was outstanding before the transfer took place.⁹³⁹

The purpose of the National Insurance Fund is to guarantee payment of specified employee claims, should an employer become insolvent. It is an important safety net where the insolvent company is unable to meet statutory preferential employee wage claims for the period preceding administration. Pollard⁹⁴⁰ provides an illuminating example of claims payable by it, when compared to payments in terms of Schedule 6:

The preferential claim (even if paid in full) may not be enough to meet the national minimum wage. £ 800 spread over four months is less than £ 47 per week. This is less than £ 1.17 per hour for a 40 hour week. The claim on the National Insurance Fund is better (although it only covers the last eight weeks). £ 230 per week works out at £ 4.79 per hour for a 48 hour week. Only if the employee works over 63 hours will this amount reduce to less than £ 3.60 per hour...⁹⁴¹

Where an employee's claim exceeds payable limits, the excess must be claimed by the employee directly from the company.⁹⁴² Once the Fund has paid out on a claim, subrogation occurs and the Fund is placed in the position of the employee.⁹⁴³

Once a contract of employment has been adopted by the administrator, it ranks in preference to his/her claim for fees.⁹⁴⁴ Walters observes that this is an important mechanism for ensuring that employees are not exploited once it is

⁹³⁹ Employment Rights Act, section 182. Even though the regulations do not clearly specify this, administration would arguably fall into the definition of 'relevant insolvency proceedings' in regulation 8(6). Section 183 of the Employment Rights Act of 1996 provides that the 'insolvency' condition will be satisfied where a company has commenced administration proceedings.

⁹⁴⁰ David Pollard *Corporate Insolvency: Employment and Pension Rights* 2 ed (2000) Butterworths.

⁹⁴¹ Pollard (2000) at 46.

⁹⁴² David Pollard (2000) at 52; Chrispas Nyombi (2013) at 421. In the case of a transfer, the transferee will be responsible for amounts exceeding these limits in terms of regulation 4(1). Upon the transfer of powers, duties and responsibilities to the transferee in terms of regulation 4(2) and consequent duty to pay amounts exceeding payable limits, it is not clear whether the subrogation in respect of claims paid by the Fund would be pursuable against the transferor or transferee. If those claims are actionable against the transferor, this would in virtually all instances be futile as after transfer, only a shell would likely remain. If it is against the transferee, this would constitute a significantly unfair result as the transferee is in any case liable for excess employee wage liabilities not paid by the Fund. From a reading of regulation 4(2)(a)&(b) and section 189 of the Employment Rights Act of 1996 it would seem that the subrogation of claims in favour of the Fund would apply against the transferee.

⁹⁴³ David Pollard (2000) at 52. The Fund may therefore rank as preferential debtor in relation to certain claims.

⁹⁴⁴ It will constitute an expense of the administration and is regulated by Schedule B1 at para 99. This is in contrast to the position in the Companies Act 71 of 2008. Section 135 relating to the ranking of creditor claims ranks the practitioner's fees in preference to that of employee, even if the latter's entitlement constitutes post-commencement finance in terms of section 135. See the discussion in Chapter 4.

adjudged that either of the purposes of administration is achievable.⁹⁴⁵ Where a contract of employment is not renewed, an affected employee is entitled to redundancy payments stipulated in the Act.⁹⁴⁶

The Insolvency Act⁹⁴⁷, as amended, provides a significant level of employee protection in the form of safety nets within administration, redundancy or liquidation. Notwithstanding the above, it imposes important limitations on pre-commencement preferential wage entitlements. The effect of this is to ensure that the financially distressed company is able to relieve itself of any contractual undertakings which, although previously commensurate in light of the company's historical performance, may be uneconomical for the company to comply with in light of its current financial circumstances.

5.2.11. DISSENTING CREDITORS

The Insolvency Act does not provide for the usurping of a dissenting creditor's claim in the manner seen in the U.S. Bankruptcy Code. Schedule B1 does however provide instances where the court may veto creditor discretion and sanction a proposal by the administrator even where it has been rejected by creditors.⁹⁴⁸

⁹⁴⁵ Adrian Walters 'The Impact of Employee Liabilities on the Administrator's decision to Continue Trading' (2005) 26(11) *Company Lawyer* at 321.

⁹⁴⁶ The provisions in relation to preference of wage claims are outlined in Schedule 6 read with sections 386 & 387 of the Insolvency Act 1986.

⁹⁴⁷ Combined with developments in European Union law.

⁹⁴⁸ This is in terms of para 55(2)(e) which provides that the court may 'make any other order (including an order making consequential provision) that the court thinks appropriate.' See further cases cited earlier in the chapter.

5.2.12. APPROVAL AND DISCHARGE

Where the approved proposal is in the form of a company voluntary arrangement, which may constitute a composition of creditors' claims or a scheme of arrangement⁹⁴⁹, it is binding on a creditor, whether or not he/she would have been entitled to vote on the proposal had he/she received notice.⁹⁵⁰ Simply stated, a creditor who did not have, or was not provided, an opportunity to vote on the proposal remains bound.⁹⁵¹

The proposal for a voluntary arrangement pursuant to Part 1 of the Insolvency Act may result in a composition and reduction of the amounts to be received by creditors in satisfaction of their claims.⁹⁵² Alternatively, a proposed scheme of arrangement may be proposed which will not result in a compromise of debt but rather a restructure of the company's debt and (or) equity.⁹⁵³

5.2.13. TERMINATION OF PROCEEDINGS

The duration of administration is for a period of twelve months but may be extended by creditors for a period of six months or for a longer period by the court.⁹⁵⁴ The extension of an administrator's term through creditor consent may occur only once.⁹⁵⁵ In addition to an automatic termination, an administrator may make an application to court for the termination of an appointment where he/she believes that the objective of administration will not be achieved, where the company should not have had recourse

⁹⁴⁹ Insolvency Act of 1986, section 1(1).

⁹⁵⁰ Insolvency Act 1986, section 4A read with section 5.

⁹⁵¹ However, a creditor may have recourse in terms of section 6 in challenging the decision on the ground that the proposed voluntary arrangement is unfairly prejudicial to its interests or that a material irregularity has been perpetrated in relation to the meeting at which the proposal was tabled.

⁹⁵² Sandra Frisby & Malcom Davis-White Q.C. *Kerr & Hunter on Receivers and Administrators* 9 ed (2010) Sweet and Maxwell at 395; *Re Adam and Partners Ltd, IRC v Adam & Partners Ltd* [2000] 1 B.C.L.C at 222.

⁹⁵³ Loubser (2010) at footnote 403 observes that the primary difference between the two is that for a composition, the company must pay some form of money in satisfaction for its debt to creditors, whereas this is not a requirement in a scheme of arrangement under the same section.

⁹⁵⁴ Schedule B1 at para 76(1) & (2) read with para 78. In terms of paragraph 4(2), the administrator has an underlying duty to perform his functions as quickly and efficiently as practicable.

⁹⁵⁵ Schedule B1 at para 78(4)(a). In determining the requisite percentage for this purpose, the voting interest of creditors who are absent or ignore an invitation to give or withhold consent is ignored.

to proceedings or where the administrator's proposals have been met with creditor rejection.⁹⁵⁶

Where the administrator is of the view that the objective of administration has been achieved, he/she may file a notice⁹⁵⁷ with the court and Registrar, which automatically terminates both the appointment and proceedings.⁹⁵⁸ Termination may also occur through voluntary creditor liquidation provided that certain requirements have been met⁹⁵⁹ or through the dissolution of the company.⁹⁶⁰

5.2.14. OBSERVATIONS

The U.K. administration procedure provides for a multi-tiered purpose which caters for a return of the company to a position of solvency, the sale of its business to a third party, leaving its corporate shell behind or a piecemeal sale of its assets. It would seem that the litmus test for determining the success of administration is the value capable of being derived by creditors through the process when compared to the value of a dividend receivable in liquidation without recourse to administration. The Act's emphasis on an administrator's discretion ensures that, notwithstanding the route through which proceedings may continue, the administrator is able to determine the greatest derivable value in all circumstances.

Linked to this multi-purpose approach is the collectivity principle, which presents itself in two forms. The first is in its attempt to derive the greatest financial benefit for the greatest number of creditors than in liquidation.⁹⁶¹ The second is in its balancing of often conflicting individual creditor interests on the one hand, with the administration being a success on the other. The courts are vested with discretion to engage in the latter exercise and determine an appropriate balance in the circumstances. Even though the collectivity principle underpins the Act, it is not inviolate and often yields to conventional notions of creditor interest and security.

⁹⁵⁶ Schedule B1 at para 79(1) & (2). A creditor may approach the court for the termination of proceedings on the basis that the appointment was based on an improper motive in terms of para 81. In addition, a creditor may approach the court on the basis that in performing his/her functions, the administrator is not doing so as quickly or as efficiently as is reasonably practicable in terms of para 74(2). The order that the court may grant is listed in sub-paras 3 and 4.

⁹⁵⁷ In the prescribed form.

⁹⁵⁸ Schedule B1 at para 80.

⁹⁵⁹ Schedule B1 at para 83.

⁹⁶⁰ Upon filing of the notice with the Registrar of Companies and sending a copy to court and all creditors, the company is deemed to be dissolved after a period of three months. See paras 84(1) & (6).

⁹⁶¹ The importance of the collectivity principle as an underpinning value, which would further guide administration as a rescue procedure, is highlighted by the U.K. Insolvency Service at para 72.

From a practical perspective, the determination of whether or not the purpose of administration is capable of being achieved is not without financial cost. Where an application is made to court for an order of administration, an evidentiary foundation must be placed before the court, establishing both financial distress as well as a reasonable prospect that the purpose of administration will be achieved. Even within the context of appointment of the administrator by the company or its directors, it has been observed that prior to making the necessary declaration, the administrator will have to engage in an in-depth investigation of the company's affairs, which may be costly.⁹⁶²

A number of controls exist within the procedure, from regulations and statutory provisions stipulating qualifications, appointment, fiduciary duties and thresholds for administrator liability to timelines dictating the pace and content of proceedings. A feature that makes administration unique is that it is a gateway procedure to other mechanisms rather than a singular process.

The Insolvency Act does not regulate the power of the administrator to accept or reject contracts once proceedings have commenced. Despite the lack of clear articulation of his /her powers to cancel contracts, there is sufficient scope for the administrator to do so in pursuance of his/her duty to do anything necessary or expedient for the management of the company's business or affairs in terms of paragraph 59(1).⁹⁶³ In addition, the Act provides a framework under which the administrator may seek directions from the court where uncertain as to the extent of the powers vested upon him/her when exercising statutory functions.⁹⁶⁴

Even though the Insolvency Act has not legislated for super-priorities, it has been argued that the U.K. approach permits prioritisation of certain expenses, which has the effect of granting a limited form of super-priority. A blanket view that no room is made for super-priority in administration is, with respect, incorrect.⁹⁶⁵

The procedure is characterised by flexibility, whether this presents itself in the form of extensions in relation to the presentation of proposals to creditors or no

⁹⁶² Loubser (2010) at 180.

⁹⁶³ It is submitted that the power to cancel contracts is narrower than the broad powers vested upon the administrator to set aside certain transactions. It would be counter-intuitive for the legislature to vest the administrator with powers similar to those of a liquidator in certain instances while deliberately excluding the power to cancel contracts which are unfair and (or) financially onerous on the company. Surely such a state of affairs cannot be said to have been envisaged.

⁹⁶⁴ Schedule B1 at para 63. See further *Transbus International Ltd [2004] supra*.

⁹⁶⁵ See Gerard McComack 'Super-priority new financing and corporate rescue' (2007) *Journal of Business Law* 701 at 729-732.

proposals at all, ranking and distributions to creditors or amendments to proposals prior to and after creditor approval. Despite this flexibility, the Act attempts to facilitate expediency whilst ensuring that creditors have recourse where prejudice occurs.

While pre-administration wage payments are to a certain degree subject to an administrator's proposals, adopted employee contracts are vested with a special status in terms of ranking and priority. Due to the developments within the European Union, the rights of employees have been enhanced with a number of obligations imposed on the employer where transfers or redundancies are contemplated.

Where wage and salary payments constitute an expense of the administration and afforded priority, such priority does not exist beyond administration should proceedings fail and the company be liquidated. There is a reversion in favour of preferences outlined in Schedule 6. This approach - in the absence of court scrutiny to which bankruptcy cases are subjected to in the U.S.⁹⁶⁶ to ensure the protection of existing secured creditors - strikes a fair balance between (i) the need to retain a critical and experienced workforce when the company needs it most while providing credence to the view that (ii) affected persons who stand to benefit most from the survival of the company should be expected to endure costs fairly commensurate to potential benefit for them.⁹⁶⁷

There is no formal procedure for the cram down of creditors who do not support proposals made. The administrator may approach a court, which may substitute its view and grant approval for the plan despite creditor dissent. This reflects the centrality of the role played by the courts.

5.3 UNITED STATES

5.3.1. NATURE AND HISTORY OF AMERICAN BANKRUPTCY LAW

U.S. Bankruptcy law can be traced back to the late 19th century era of railroad construction and development.⁹⁶⁸ Railroad companies often found themselves in financial distress with no existing reorganisation mechanisms, resulting in parties essentially being left to their own devices.⁹⁶⁹ In order to deal with the uncertainty that bankruptcy presented, equity receivership was invented as an instrument for

⁹⁶⁶ This is discussed later.

⁹⁶⁷ As we will see later, chapter 11 introduces controls which ensure that certain creditors are not burdened disproportionately with the costs of the reorganisation. A simple example of this is seen in the application of the doctrine of 'adequate protection'.

reorganisation when unexpected financial circumstances led to the railroad enterprise being insolvent.⁹⁷⁰

Despite the fair outcomes which were envisaged, creditors were often prejudiced during the process.⁹⁷¹ The courts attempted to level the playing field, introducing doctrines such as the ‘absolute priority rule’. The rule demanded that shareholders of the bankrupt company could only retain their interest when all creditors had received payment.⁹⁷² The New Deal⁹⁷³ led to the introduction of a new Chapter X of the Bankruptcy Act of 1898.⁹⁷⁴ The purpose of the chapter was to ensure the protection of public investors who were often senior bondholders and required mandatory appointment of a trustee who would replace existing management, a judicial valuation of the debtor company’s reorganisation as well as distribution value.⁹⁷⁵

The Bankruptcy Act of 1898 was geared not as a ‘debtor jubilee’, as one commentator remarked, but was aimed at facilitating equitable administration of the debtor’s estate to its creditors.⁹⁷⁶ In this way the 1898 Act was essentially procedural and administrative in its orientation.⁹⁷⁷ An additional Chapter was later introduced by the Chandler Act⁹⁷⁸ and was designed to cater for small private firms.⁹⁷⁹ Through its revision of certain parts of the 1898 Act, the Chandler Act reforms included an update of both substantive and procedural aspects in liquidation cases as well as the

⁹⁶⁸ Yongqing Ren *A Comparative Study of the Corporate Bankruptcy Reorganization Law of the US and China* (2012) Netherlands: International Publishing at 5.

⁹⁶⁹ Ren (2012) at 5.

⁹⁷⁰ Douglas G. Baird and Robert K. Rasmussen ‘Control Rights, Priority Rights and the Conceptual Foundations of Corporate Reorganization’ (2001) 87 *Virginia L.Rev.* 921; Douglas G. Baird and Robert K. Rasmussen, ‘Boyd’s Legacy and Blackstone’s Ghost’ (John M. Olin Program in Law and Economics Working Paper no. 94, 2000); Douglas G. Baird *Elements of Bankruptcy* (2010) New York: The Foundation Press; Charles Jordan Tabb ‘The History of the Bankruptcy Laws in the United States’ (1995) 3 *American Bankruptcy Law Review*.

⁹⁷¹ Tabb (1995) at 22.

⁹⁷² Tabb (1995) at 22. Others included the ‘upset price’ control mechanism; See further *Northern Pacific Railway Company v Boyd*, 228 U.S. 482, 501-8 (1913).

⁹⁷³ Briefly discussed in Chapter 2.

⁹⁷⁴ Introduced through the Chandler Act of 1938. See Ren (2012) at 7. See further Adam C Pritchard and R B Thompson ‘Securities Law and the New Deal Justices’ (2009) 95(4) *Va. L. Rev.* 841.

⁹⁷⁵ Ren (2012) at 6.

⁹⁷⁶ Tabb (1995) at 25.

⁹⁷⁷ Tabb (1995) at 25.

⁹⁷⁸ Tabb (1995) at 29 observes that the Chandler Act was the culmination of a careful study of U.S. bankruptcy law. The Act was championed by Congressman Walter Chandler. It was introduced in 1936 and enacted in 1938.

⁹⁷⁹ Chapter XI had two distinguishing features, namely that existing management of the debtor company was not displaced and, unlike Chapter 10, no Securities Exchange Committee evaluation of the plan was necessary. See further David A. Skeel, Jr ‘An Evolutionary Theory of Corporate Law and Corporate Bankruptcy’ (1998) 51 *Vand. L. Rev* 1325.

improvement of bankruptcy administration.⁹⁸⁰ The Act further provided a rework of the chapters governing corporate reorganisations, arrangements, property arrangements as well as provision for wage earner's plans.⁹⁸¹

The Commission on the Bankruptcy Laws of the United States was later established in 1970 to study the existing bankruptcy law.⁹⁸² The process resulted in comprehensive reforms being introduced in 1978 as an attempt at ensuring unification of Chapter X and XI of the 1898 Act⁹⁸³ and culminated in the enactment of the Bankruptcy Reform Act of 1978.⁹⁸⁴ The new Code contained public protective mechanisms seen in the previous Chapter X⁹⁸⁵ but was also flexible enough to allow adjustment of debt, both secured and unsecured, and equity during reorganisation.⁹⁸⁶ Having briefly discussed the history, I now turn to deal with an analysis of the relevant provisions of the Bankruptcy Code.

5.3.2. FILING FOR BANKRUPTCY: NOTICE REQUIREMENTS

Upon filing a petition for bankruptcy, a debtor company must ensure that schedules listing *inter alia* its assets and liabilities, income and expenditure, executory contracts and unexpired leases as well as the company's overall financial affairs are submitted.⁹⁸⁷ This information provides creditors with an outline of the debtor's current financial status and creates a basis for them to adequately vindicate their rights should they deem necessary. It also enables an assessment into the legitimacy of the filing and the question whether a 'reorganisation purpose' actually exists. The latter concept is explored at a later stage.⁹⁸⁸

⁹⁸⁰ Tabb (1995) at 29-30.

⁹⁸¹ Tabb (1995) at 29-30.

⁹⁸² In terms of Public Law 91-354, 84 Stat. 468 effective 24 July 1970.

⁹⁸³ The United States Congress appointed a commission to conduct an investigation into then existing Bankruptcy Laws in 1970. Three years later the commission filed its report in 1973, which resulted in the Bankruptcy Reform Act of 1978. See *Report of the Commission on the Bankruptcy Laws of the United States* Parts I and II House Report Document number 137, 93d Congress, First Session (1973).

⁹⁸⁴ The Bankruptcy Reform Act of 1978 also known as the 'US Bankruptcy Code'. This came into effect on the 1 October 1979. See Ren (2010) at 8.

⁹⁸⁵ Bankruptcy Act of 1938.

⁹⁸⁶ Ren (2012) at 7-8. For further reading see Kenneth N. Klee 'Legislative History of the New Bankruptcy Law' (1979) 28 *DePaul Law Review* 941.

⁹⁸⁷ Federal Rules Bankruptcy Procedure Rule 1007(b). It is to be observed that the term 'executory contract' is not defined in the Code.

⁹⁸⁸ This is in comparison to section 129 commencement proceedings in the 2008 Act, where a director resolution and an affidavit stating circumstances surrounding financial distress is sufficient. While certain creditors may be privy to company financial information before financial distress occurs, this right is not one which all creditors share.

A notice of filing is sent to the company's listed creditors by the bankruptcy clerk. Where a creditor is not listed in schedules or where its claim is listed as contingent or unliquidated or disputed, the creditor must ensure that its proof of claim is filed in order to protect its rights.⁹⁸⁹ If a creditor claim is scheduled and is neither contingent nor disputed, a proof of claim need not be filed.⁹⁹⁰ The effect of chapter 11 is to discharge the company from its debts even if claims, which formed the basis for its debts were not filed and scheduled.⁹⁹¹

5.3.3. FINANCIAL DISTRESS

The chapter 11 bankruptcy process commences with the voluntary filing of a debtor company's petition with a bankruptcy court.⁹⁹² The petition must include a list of the company's creditors as well as its assets and liabilities.⁹⁹³ It is generally not a requirement that the company be insolvent⁹⁹⁴ in order to access the procedure.⁹⁹⁵ This aspect makes chapter 11 unique in comparison to its comparative counterparts. A company may file for bankruptcy to avoid an impending liability for damages.⁹⁹⁶

Creditors may force involuntary bankruptcy proceedings upon a debtor company. This may occur where creditors are owed a minimum amount of USD 10 000, with the amount remaining unpaid by the debtor company.⁹⁹⁷ Where involuntary bankruptcy liquidation proceedings are commenced, the debtor may in

⁹⁸⁹ Federal Rules of Bankruptcy Procedure 3003(c)(2); see Baird (2010) at 79.

⁹⁹⁰ 11 U.S.C § 1111(a).

⁹⁹¹ Baird (2010) at 79.

⁹⁹² McComack (2008) at 123-4.

⁹⁹³ McComack (2008) at 123-4.

⁹⁹⁴ The term 'Insolvent' is defined in § 101(32) of the Code as one where the fair value of the company's assets is exceeded by the sum of its debts.

⁹⁹⁵ However, slightly different approaches apply depending on whether the filing is voluntary or involuntary. Involuntary filings are regulated by § 303. Section 301 dealing with voluntary filings requires the applicant to be a debtor in terms of the Chapter. The definition of 'debtor' is in turn to be found in § 109.

⁹⁹⁶ Whether in contract or delict. An example of this maybe be seen in *In re Texaco Inc* 84 B.R. 893, 902 (Bankr. S.D.N.Y.1988). In this case Pennzoil had obtained judgment against Texaco for approximately 10 billion USD. Texaco's shares were worth about 8.5 billion USD effectively rendering it insolvent. Texaco filed for bankruptcy in terms of chapter 11 and through the procedure, was able to reduce its exposure to 3 billion USD.

⁹⁹⁷ McComack (2008) at 79.

turn convert these into chapter 11 proceedings.⁹⁹⁸ There is, however, a requirement that the petition be filed in good faith⁹⁹⁹ with the intention of bringing about a corporate restructuring or a liquidation sale of the company.¹⁰⁰⁰ A petition may be dismissed where there is no reorganisation purpose.¹⁰⁰¹

5.3.4. MANAGEMENT CONTROL

Once bankruptcy proceedings have formally commenced, existing management remains in control of company operations; hence the term ‘debtor-in-possession’.¹⁰⁰² One justification for this approach is that management can be depended upon to carry out their responsibilities in the same manner or even better than a trustee.¹⁰⁰³

Management may, however, be displaced under certain circumstances. An external trustee may be appointed ‘for cause’, where fraud, dishonesty, incompetence or gross mismanagement has been perpetrated by existing management.¹⁰⁰⁴ American courts have been conservative on this aspect, stressing that the appointment of an outside trustee should be an exception rather than the norm.¹⁰⁰⁵ It is to be observed

⁹⁹⁸ 11 U.S.C § 706. See Charles W. Adams ‘An Economic Justification For Corporate Reorganization’ (1991) *Hofstra Law Review* 117 at 134. Adams argues that reorganisation is borne out of two conditions. The first is that the value of a debtor’s assets, at going concern value, must be exceeded by its liabilities and that the same going concern value of assets must exceed their liquidation value. He sees reorganisation as playing the role of mediating the often conflicting interests of creditors and shareholders when insolvency occurs and as creating an ‘adequate equity cushion’ with the effect of mitigating shareholder risky behaviour at the expense of the debtor company’s creditor. For further reading, see B Carruthers, B & T Halliday *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* (1998) Oxford: Clarendon Press.

⁹⁹⁹ And not with the intention of delaying or frustrating creditors’ rights.

¹⁰⁰⁰ McComack (2008) at 79 and 124. See *In re Integrated Telecom Express, Inc.*, 384 F. 3d 108 (3rd Circuit Division, 2004).

¹⁰⁰¹ See *SGL Carbon Corporation* 200 F. 3d 154 (3rd Circuit, 1999). The *fides* of a petitioner is a relevant factor in the enquiry to be analysed in light of the objective assessment regarding the feasibility of the proposed reorganisation, see *CAROLIN CORP. v. MILLER* 886 F.2d 693 (4th Cir. 1989).

¹⁰⁰² 11 U.S.C § 1107(a).

¹⁰⁰³ See *Commodity Futures Trading Commission v Weintraub* 471 US 343, 355 (1985); Jay Lawrence Westbrook ‘Reorganisation in the United States’ in Harry Rajak (1993) at 351. See further Richard Posner ‘Foreword’ in J Bhandari and L Weisseds (eds) *Corporate Bankruptcy: Economic and Legal Perspectives* (1996) Cambridge: Cambridge University Press.

¹⁰⁰⁴ See § 1104(a)(1).

¹⁰⁰⁵ See *Re Marvel Entertainment Group* (1998) 140 F 3D 463 at 471.

that the debtor has an underlying fiduciary duty to act in the interests of its creditors.¹⁰⁰⁶

5.3.5. MORATORIUM ON PROCEEDINGS

Once a company files for bankruptcy, a moratorium¹⁰⁰⁷ on proceedings against it comes into effect.¹⁰⁰⁸ Any legal action in the form of a judgment or enforcement of security or other debt-collection measure may only proceed outside bankruptcy court once permission to proceed has been granted by the bankruptcy court.¹⁰⁰⁹ In the absence of the court's consent, a prospective litigant-creditor faces potential contempt of court actions as well as penalties.

Criminal proceedings are not barred; therefore directors of the debtor may be held criminally liable for the company's conduct.¹⁰¹⁰ In such instance, the Bankruptcy Code makes provision for the appointment of an external trustee as a measure of ensuring that operations continue.¹⁰¹¹ The Code also provides sufficient flexibility regarding the powers of the court to impose a non-automatic stay of actions.¹⁰¹²

There is an expansive list of exceptions to the application of the moratorium which has been explained on the basis of compromises reached through lobbying and political expedience.¹⁰¹³ A creditor may apply for the lifting of the stay and the court in such instance may confirm, annul, terminate or make the stay subject to certain conditions.¹⁰¹⁴ The stay may be lifted on a number of grounds. This includes instances

¹⁰⁰⁶ The debtor-in-possession's fiduciary duties are to be found in §§1107(a) read with 1106(a)(1) and 704. § 704(a)(1) requires the Debtor-in-possession to act in the best interests of 'parties in interest' and provides a list of functions which must be performed. Upon a reading of the Code and its Rules, such party(ies) are inclusive of the debtor's creditors as well as creditor committees. See *In Re CoServ LLC* 273 B.R. 487 (Bankr. N.D. Tex. 2002) at 498, where the court held as follows:

'...The Court believes such a bridge exists in the debtor in possession's role as the equivalent of a trustee...A debtor in possession, like a trustee, is a fiduciary holding the bankruptcy estate and operating the business for the benefit of its creditors and (if the value justifies) equity owners...'

See further the observations of the court in *In re Bear Stearns Litig.*, 23 Misc. 3d 447, 475 (N.Y. Sup. Ct. 2008). See further *Sherr v Winkler* 552 F. 2d 1367, 1374 (10th Circuit 1977).

¹⁰⁰⁷ Referred to as a 'stay'.

¹⁰⁰⁸ 11 U.S.C §362(a). This includes property belonging to the debtor as well as that belonging to a third party but within the debtor's possession.

¹⁰⁰⁹ Bankruptcy Code, §§ 362(a) & 362 (d). Different rules apply in the case of the single-asset real estate debtor. With this debtor, creditors are granted greater powers of recourse where the onus is shifted to the debtor company. See 11 U.S.C § 362(d) & 362(d)(3).

¹⁰¹⁰ 11 U.S.C § 362(b)(4).

¹⁰¹¹ 11 U.S.C § 1104.

¹⁰¹² 11 U.S.C § 105.

¹⁰¹³ McComack (2008) observes this aspect at 160-161 and the Congressional impetus for a narrow interpretation of these exceptions.

¹⁰¹⁴ Bankruptcy Code, § 362(d).

where the applicant creditor is able to show that the petition fails to provide ‘adequate protection’ for the creditor’s interest in the property¹⁰¹⁵, where property is applied in security for a lien and the debtor fails to show that it has an equity interest in the property or where the property is not essential for the carrying out of the reorganisation.¹⁰¹⁶ If a creditor is able to show that the debtor no longer has any equity in the collateral, to avoid the lifting of the stay the debtor will bear the onus of proving to the court that the secured property is in fact necessary for a successful reorganisation.¹⁰¹⁷

5.3.6. PROTECTION OF PROPERTY INTERESTS

In protecting the proprietary interests of stakeholders, the Code provides that the debtor company is not entitled to apply ‘cash collateral’ during or outside the ordinary course of business without consent of the court or the relevant secured party.¹⁰¹⁸ The debtor company may, however, sell, lease or use other property belonging to the estate in the ordinary course of business without having to approach the court for authorisation.¹⁰¹⁹

The Code’s imposition of limitations on the manner in which the debtor may apply ‘cash collateral’ ensures that the secured creditor does not unduly bear the costs of the reorganisation. It is submitted that this approach further provides a measure of protection for pre-bankruptcy contractual agreements as well as certainty in the lending markets.¹⁰²⁰ Thus, where lending within the pre-bankruptcy context, creditors are better able to factor and account for risk in their lending agreements.

¹⁰¹⁵ 11 U.S.C §361 read with § 362(d)(1).

¹⁰¹⁶ 11 U.S.C § 362(d)(2)(A) & (B). Conversely, if the debtor is able to show that it has an equity interest in the property or that the property is essential for the carrying out of the reorganisation the creditor is likely to fail in its bid to have the stay lifted by court.

¹⁰¹⁷ See *United Timbers Association of Texas v Timbers of Inwood Forest Associates Ltd* 484 U.S. 365 (1988). The debtor company may in certain circumstances have to ensure that ‘adequate protection’ is provided for the benefit of certain creditors in terms of § 361.

¹⁰¹⁸ ‘Cash collateral’ is defined in § 363(a) as inclusive of cash, negotiable instruments, documents of title, securities, deposit accounts or what the Code refers to as ‘cash equivalents’ whenever acquired and where a third party entity has an interest therein.

¹⁰¹⁹ 11 U.S.C § 363(c). ‘Adequate protection’ may have to be produced by the debtor company to ensure that the relevant secured creditor’s interests are protected.

¹⁰²⁰ This is in contrast with the South African approach where the practitioner may in certain instances dispose of property over which a party has a security interest without such security holder’s specific consent.

5.3.7. CONTRACTS

The debtor is entitled to assume or reject non-personal executory contracts.¹⁰²¹ Where a contract is in default, this default (unless of a specified nature relating to insolvency or financial condition) must first be cured and an assurance of future performance must be provided before the contract can be assumed.¹⁰²²

The assumption, assignment (whether or not the contract by its terms prohibits assignment) or rejection of contracts occurs under court supervision.¹⁰²³ The process is initiated through summary motion proceedings by the debtor or trustee and may be objected to by the debtor-in-possession's creditors.¹⁰²⁴ During the hearing, the court will make preliminary findings in relation to aspects such as the breach or cure of applicable contracts. In this regard the court will, in large part, defer to the debtor's 'business judgment' in respect of contracts which the latter may wish to assume or reject.¹⁰²⁵ This also provides an opportunity for an affected party to state its case in relation to the proposed cancellation, assumption or assignment.¹⁰²⁶ An approved cancellation or rejection constitutes a breach of contract, entitling an affected party to a pre-petition damages claim against the debtor.¹⁰²⁷

In addition to the power to assume or reject executory contract, the debtor may avoid certain transactions preceding the filing of the petition.¹⁰²⁸ The Code refers to

¹⁰²¹ 11 U.S.C § 365(a) & (b). See further Westbrook at 356 in Rajak (1993). Where an executory contract has not been properly rejected, obligations and responsibilities attendant upon it are accepted as having been assumed and will rank as an administrative expense, see *Adventure Resources Inc. v Holland* 137 F.3d 786, 798 (4th Cir. 1998) at paragraphs 14-17.

For further reading on this point, see *In re Mushroom Transport Co., Inc* 78 B.R 754, 759 (Bankr. E.D.Pa 1987); *LJC Corp. v Boyle* 768 F.2d 1489, 1494 (D.C. Cir. 1985) ; *In re French*, 131 B.R 138, 141 (Bankr.E.D.Mo. 1991).

¹⁰²² See § 365(b)(1)(A) & (C). The position is different where an executory contract is rejected. On the consequences, see *In Re Thompson* 788 F.2d 560, 563 (9th Cir. 1986).

¹⁰²³ 11 U.S.C § 365(a). The court in *In re Prime Motor Inns* 124 B.R. 378, 382 (Bankr. S.D. Fla. 1991) affirmed 'business judgment' as expounded upon by the Supreme Court in the earlier *In re Bildisco* *infra* case at 80 as the appropriate test for rejection of ordinary contracts: For a reading on the business judgment test, see *In re Minges* 602 F.2d 38 (2nd Cir. 1979).

¹⁰²⁴ *In re Orion Pictures Corp.* 4 F.3d 1095, 1099 (2^d Cir.1993).

¹⁰²⁵ However, the court will engage in its own 'business judgment' analysis of a debtor's decision to assume a contract. See *In re F.W. Restaurant Assocs. Inc.*, 190 B.R. 143, 148 (Bankr. D. Conn. 1995).

¹⁰²⁶ It is to be noted that the proceedings are 'summary' in nature.

¹⁰²⁷ 11 U.S.C § 365(g). *In re Drexel Burnham Lambert Group, Inc.* 138 B.R. 687, 707 (Bankr.S.D.N.Y. 1992) at 707 the court, having broadly canvassed the literature on this point, concluded:

'...we believe that the plain language of § 365...compels the conclusion that a rejected contract is actually breached, and the breach is deemed to have occurred immediately preceding the bankruptcy filing...'

Where a damages claim arises as a result of the termination an employment contract, it will be subject to limitations imposed by 11 U.S.C. § 502(b)(7). The termination of collective bargaining agreements is discussed below.

¹⁰²⁸ The 11 U.S.C §§ 544(b), 547(b) and 548.

the trustee (debtor-in-possession) avoiding ‘...any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is *voidable*...’¹⁰²⁹ This is an example of fraudulent conveyance law, which grants the debtor state law powers of avoidance.¹⁰³⁰ For the avoidance of a voidable preference to occur, the debtor must have been insolvent when the transfer occurred and the transfer must have resulted in a distribution greater than that which would have been received had the debtor been liquidated or had the transfer not been made.¹⁰³¹

5.3.8. POST-COMMENCEMENT FINANCING

The debtor company may solicit financing after filing for bankruptcy. Where obtained, it may be categorised as an ‘administrative expense’ or accorded super priority over other administrative expenses already encumbering the property.¹⁰³²

It has been advanced that the reason why companies in chapter 11 proceedings require post-petition finance may be due to the fact that most, if not all, of the company’s cash is often subject to a lien as ‘proceeds of encumbered property’ or subject to a ‘right to set-off’.¹⁰³³ In this way, the cash or cash equivalent is treated as ‘cash collateral’ which requires court sanction for the debtor company to utilise it in the absence of a lienholder’s consent.¹⁰³⁴

Post-petition finance may be accorded a ranking higher to that of an administrative expense depending on the availability of assets belonging to the debtor company.¹⁰³⁵ Should proceedings be converted into liquidation in terms of Chapter 7, the priority ranking remains.¹⁰³⁶ If credit has been extended to the company in the ordinary course of business post-petition, the priority will be automatic while credit granted outside of the ordinary course requires court approval.¹⁰³⁷

¹⁰²⁹ My emphasis. 11 U.S.C § 544(b)(1). The term ‘transfer’ is broadly defined in § 101(54). § 1107 grants the debtor-in-possession similar powers to a trustee. See further the provisions of § 547(b).

¹⁰³⁰ Baird (2010) at 139. See further § 548.

¹⁰³¹ 11 U.S.C § 547(b). The transaction must have occurred 90 days before filing in the case of an ‘outsider’ and up to a period of one year in the case of an ‘insider’. The ambit for avoidance is much greater (two years before filing) in the case of fraudulent transactions in terms of § 548. It is clear that the powers of the debtor-in-possession in this regard are significant, allowing for extensive recoupment of assets.

¹⁰³² Subject to certain conditions. 11 U.S.C § 364(c) & (d).

¹⁰³³ Set-off provisions are stipulated in § 553. See Westbrook in Rajak (1993) at 355.

¹⁰³⁴ 11 U.S.C § 363(c)(2).

¹⁰³⁵ David A. Skeel J ‘Creditor’s Ball: The “New” Corporate Governance in Chapter 11’ (2003) 152 *University of Pennsylvania Law Review* 917 at 923.

¹⁰³⁶ 11 U.S.C § 726. See further McComack (2008) at 85.

¹⁰³⁷ 11 U.S.C § 364(a) & (b).

Super-priority financing and debt priming occurs within specifically defined parameters which ensure that existing security interests are not unduly compromised. The first measure is that an application for obtaining such credit must be made to the court.¹⁰³⁸ The second is that in deciding whether to permit or reject the application, the court will enquire whether adequate protection has been provided for existing creditors.¹⁰³⁹ The consequence is that where a creditor is granted higher ranking in respect of post-petition finance advanced, for instance, and the debtor is subsequently liquidated; adequate provision would already have been made for the protection of pre-bankruptcy secured creditors.

5.3.9. PLAN PUBLICATION

The debtor is required to propose a plan within one hundred and twenty days after having filed for bankruptcy.¹⁰⁴⁰ This is referred to as the ‘exclusivity period’ i.e. the period during which only the debtor may propose a plan.¹⁰⁴¹ The plan must be accepted by creditors within a period of one hundred and eighty days of filing for the exclusive period to continue.¹⁰⁴² The latter timeline may be extended by the court, on good cause shown, for a period not exceeding twenty months.¹⁰⁴³ Some commentators have posited that despite the capping of the exclusivity period in the Code (as compared to its predecessor), it remains too long.¹⁰⁴⁴

A number of outcomes may result. The debtor may propose a ‘standalone plan’, which entails stakeholders concerned (secured, unsecured creditors and in rare instances, equity holders) consenting to a reorganisation without the intervention of a third party in the form of a purchaser for the business. The plan may seek to

¹⁰³⁸ 11 U.S.C §364.

¹⁰³⁹ 11 U.S.C §364(c) &(d).

¹⁰⁴⁰ 11 U.S.C § 1121(c)(2).

¹⁰⁴¹ This period may be extended by a competent court to a period not exceeding 18 months after the date on which the petition was filed. See Bankruptcy Code para 1121(d)(2)(A). The 18 month period was introduced by Congress to allay fears by critics who argued that debtor companies could abuse the process to further their own ends.

¹⁰⁴² 11 U.S.C 1121(c)(3). The acceptance must be by each class of creditor whose claim or interest is impaired by the plan.

¹⁰⁴³ 11 U.S.C 1121(d)(2)(B).

¹⁰⁴⁴ Introduced by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005); Edward I. Altman ‘Evaluating the Chapter 11 Bankruptcy-Reorganization Process’ (1993) 1 *Columbus Business Law Review* at 3; Foteini Teloni ‘Chapter 11 Duration, Pre-Planned Cases and Refiling Rates: An Empirical Analysis in the Post-BAPCPA Era’ (2015) 23 *American Bankruptcy Institute Law Review* 571 at 573 observes that shorter timeframes have been linked with higher refiling rates due to the amendments forcing the debtor to ignore operational problems in pursuit of expedited proceedings. For further reading, see M Bradley and M Rosenweig ‘The Untenable Case for Chapter 11’ (1992) 101 *Yale Law Journal* 1043.

compromise of the claims of creditors.¹⁰⁴⁵ Alternatively, the plan may envisage a sale of the business, distributing the proceeds to creditors. A third party investor may be introduced for a capital injection on loan account or in exchange for equity. Another option may be in the form of a ‘liquidation plan’, provided that each creditor receives at least what it would have received in liquidation.¹⁰⁴⁶

The Bankruptcy Code allows the company’s creditors to propose their own plans after the expiry of the exclusivity period, which may well compete with the debtor-in-possession’s proposed plan.¹⁰⁴⁷ The approach is justified on the basis that creditors are best placed to determine whether a proposed plan furthers their interests.¹⁰⁴⁸

5.3.10. DISCLOSURE STATEMENT

A disclosure statement and plan of reorganisation must be filed at court. It is only after approval of the disclosure statement by the court that the debtor company may approach and persuade its creditors to accept the proposed plan.¹⁰⁴⁹ The disclosure statement must contain ‘adequate information’ which is described as

...information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor’s books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan...¹⁰⁵⁰

The Code distinguishes a ‘small business case’¹⁰⁵¹ providing that in such a case the court may deem it unnecessary for the debtor to circulate a disclosure statement to creditors in soliciting their vote, once the court has determined that the

¹⁰⁴⁵ This is termed a ‘composition’.

¹⁰⁴⁶ 11 U.S.C § 1129.

¹⁰⁴⁷ 11 U.S.C §1121(c).

¹⁰⁴⁸ *Bank of America v 203 North LaSalle Street Partnership* 526 US 434 (1999). In addition, the debtor would have had the advantage of an exclusivity period in order to try and get its preferred plan accepted.

¹⁰⁴⁹ 11 U.S.C § 1125(b). For a multi-staged bargaining process analysis of chapter 11 through the prism of game theory, see Amira Annabi, Michele Breton & Pascal Francois ‘Resolution of Financial Distress under Chapter 11’ (2012) 36 *Journal of Economic Dynamics and Control* 1867-1887.

¹⁰⁵⁰ 11 U.S.C § 1125(a)(1). This provision, which regulates information to be provided to creditors, is similar to that seen in section 150(2) of the Companies Act of 2008. The enquiry, being one into whether information provided to a creditor will enable it (or a hypothetical creditor) to make an informed judgment about the plan, is made by the bankruptcy court. In South Africa, the court has to be invited to make this determination. The South African provision is discussed in the previous chapter.

¹⁰⁵¹ The definition of the term is found in § 101(51C) and a ‘small business debtor’ in § 101 (51D).

plan itself contains adequate information.¹⁰⁵² The Code allows for modification of the plan before or after it has been confirmed by the court. The conditions for modification are that the plan must comply with §§ 1122 and 1123 of the Code. In addition, where the debtor-in-possession seeks to modify the plan after confirmation by the court, it must not have been substantially implemented.¹⁰⁵³

5.3.11. VOTING

Once the disclosure statement has received the requisite approval from the court, creditors may vote to approve or reject the plan. For the purpose of voting, the Code distinguishes between unimpaired and impaired creditors. A creditor is impaired if its pre-bankruptcy rights are to be compromised. It is the latter category whose votes are relevant for the purposes of plan adoption.¹⁰⁵⁴

Creditors are designated into classes and the plan must provide for classification of claims and the manner in which claims will be treated.¹⁰⁵⁵ A plan is adopted by a class where it receives favourable votes from a two-thirds majority in value and a simple majority in the number of allowed claims in a class.¹⁰⁵⁶ A plan is deemed to have been accepted by a class of shareholders or other interest holders if those holding at least two-thirds in the amount of the total allowed interests held by members voting, vote in support.¹⁰⁵⁷ Where a class of impaired creditors rejects the plan, the absolute priority rule is revived in relation to that class.¹⁰⁵⁸ To the extent that a class will not receive any interest in terms of the plan, it is deemed to have voted against it.

¹⁰⁵² 11 U.S.C § 1125(f). Despite a relaxing of informational requirements in relation to small businesses, such enterprises are still required to present their proposed plan to court.

¹⁰⁵³ The Code makes use of the term ‘substantial consummation’. § 1127(a) & (b).

¹⁰⁵⁴ U.S.C. 11 § 1129(a)(7)(A). See further § 506 which provides for the splitting of an under secured claim into two separate claims, taking into account the value of the security as well as the value of the deficiency. The Companies Act 2008 adopts a different approach, focusing on the full amount owed to a creditor (to determine voting interest) and does not factor the extent to which such creditor is secured. This aspect is discussed in Chapter 4. See Maria Brouwer ‘Reorganization in US and European Bankruptcy law’ (2006) *European Journal of Law and Economics* 22 at 12.

¹⁰⁵⁵ Chapter 11, §§ 1122 and 1123(a)(2)(3).

¹⁰⁵⁶ 11 U.S.C § 1126(c).

¹⁰⁵⁷ 11 U.S.C § 1126(d).

¹⁰⁵⁸ Brouwer (2006) at 12 argues that secured creditors are deemed to have accepted the plan as they are not an impaired class where pre-petition loan conditions are continuing, post-petition. The commentator further observes that under-secured creditors have an election of having their entire claim secured without receiving immediate payment or to be paid at foreclosure value, thus voting with the body of impaired creditors to the extent that their claim is unsecured.

5.3.12. TREATMENT OF CREDITORS

5.3.12.1. CRITICAL VENDORS

The debtor company may seek judicial sanction to pay unsecured creditors falling into what is termed ‘critical’ vendors. These are payments to vendors whose supplies are deemed essential for the company to continue its business.¹⁰⁵⁹ Even though not crystallised in chapter 11, the critical vendor doctrine has been said to predate the 1978 Code. The Code’s silence on this aspect has been interpreted by some as implied recognition for its application and viability. Proponents have argued that the lack of specific prohibition indicates implicit assent on the part of Congress to its existence.¹⁰⁶⁰

Resnick¹⁰⁶¹ observes the historical origins of the doctrine:

The doctrine of necessity—that is, court-approved payment of unsecured pre-bankruptcy claims before a Chapter 11 plan is confirmed—has its origin in the nineteenth century railroad receivership cases. Two similar doctrines developed at that time. First, railroad receiverships in the 1800s recognized an equitable rule of priority, known as the “six-months rule”, which authorized receivers to pay the unpaid claims of “operating creditors” arising within the six-month period immediately preceding the receivership case... Similar in concept to, but separate and distinct from, the six months rule, “the necessity of payment doctrine” also developed in nineteenth-century railroad receivership proceedings. Since first enunciated in the 1882 decision of the U.S. Supreme Court in *Miltenberger v Logansport Railway Co.*, the doctrine became an important part of railroad reorganizations and receiverships...¹⁰⁶²

He further outlines its pedigree as distinguishable from its erstwhile counterpart, the ‘six-month’ doctrine:

...the “doctrine of necessity,” as it came to be known later, is not a rule establishing priority of claims; rather, it is a doctrine giving courts the discretion to deviate from the otherwise applicable rules of priority by making early payments to certain creditors to achieve the goal of a successful reorganization. Whereas the six month rule directly changes the priority of claims by paying ordinary course claims incurred within six months prior to a railroad reorganization before secured claims, the doctrine of necessity permits payment of pre-bankruptcy unsecured claims only when such payment is needed so that trade vendors or other creditors will not refuse to supply critical goods and services after the debtor files for bankruptcy protection.¹⁰⁶³

¹⁰⁵⁹ McComack (2008) at 83.

¹⁰⁶⁰ Others have in turn argued that a lack of codification indicates intent of its demise. For further reading on the different arguments raised on this aspect see Joshua A Erhrenfeld ‘Quieting the Rebellion: Eliminating Payment of Prepetition Debts Prior to Chapter 11 Reorganizations’ (2003) 70 *Chicago Law Review* 621; Victor A Vilaplana ‘Stretching the Code for Critical Vendors: Necessity is the Mother of Invention’ in 26th *Annual Current Developments in Bankruptcy and Reorganization* (2004) 491 at 528 New York: Practising Law Institute.

¹⁰⁶¹ Alan Resnick ‘The Future Doctrine of Necessity and Critical Vendor Payments in Chapter 11 Cases’ (2005) 47 *Boston Law Review* 183. The courts have relied on their broad equitable powers in § 105(a) for payment of certain pre-petition vendors.

¹⁰⁶² Resnick (2005) at 187-88.

¹⁰⁶³ Resnick (2005) at 187-188. Anthony Michael Sabino ‘The Death of Critical Vendor Motions and the Potential Demise of the Doctrine of Necessity: Farewell to Two Misbegotten Doctrines’ (2004) Vol. 6 *Transactions: The Tennessee Journal of Business Law* 47.

The doctrine has been applied in the payment of employee wages claims accrued prior to bankruptcy as distinct from post-petition wages, which would constitute an administrative expense.¹⁰⁶⁴ The equitable powers granted in § 105(a) and, by inference, the critical vendor doctrine has received restricted interpretation from appeal courts.¹⁰⁶⁵

5.3.12.2. ASCENDANCY OF THE CREDITOR

McComack observes that recent developments have seen a shift in emphasis from reviving the corporation towards maximising returns to creditors.¹⁰⁶⁶ The increase in debt trading has been viewed as a contributing factor, where institutions buy up debt of distressed companies, while having no real interest in long-term relationships with the company or sustaining trading links.¹⁰⁶⁷

This view has been advanced further, with some arguing that chapter 11 has come to represent the specific interests of secured creditors.¹⁰⁶⁸ While conceding the position that lender-creditors have become dominant in large bankruptcies, Gross¹⁰⁶⁹ disagrees with the view that it is only the interests of secured creditors which are accorded primacy. She observes:

¹⁰⁶⁴ Resnick (2005) at 192. See however its seeming rejection by the court in *Re Kmart Corp* 359 F.3d 866, 871 (7th Circuit, 2004) as a doctrine expressly sanctioned by the Code. Further developments have occurred with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

¹⁰⁶⁵ In other instances, it has received outright rejection. On the approach adopted the courts, see *Official Committee of Equity Holders v Mabey* 832 F. 2d 299 (4th Circuit 1987) at 302. *B & W Enterprises Inc v Goodman Oil Company (In re B & W Enterprises Incorporated)* 713 F.2d 534 at 537 (9th Circuit, 1983); *Chiasson v J Louis Matherne & Associates (In re Oxford Management Incorporated)* 4 F. 3d at 1334 (5th Circuit 1993) *cf In re CoServ LLC supra*. At 493 the court expressed doubt in relation to §§ 549 and 363(b)(1) as support for the court's exercise of power to authorise pre-petition claims. It further held that even though it could exercise equitable powers in terms of § 105(a), these powers were severely circumscribed. The judgment, having been delivered by the same judge in both matters, was followed in *In re Mirant Corp.* 296 B.R. 427 (Bankr. N.D. Tex. 2003). However see the *dictum* of the court in the more recent *Kmart case: In reKmart Corporation* 359 F.3d 866 *supra*. In this case the court rejected the critical vendor doctrine as a basis for paying pre-petition supplier creditors, suggesting that such payments may be sanctioned in terms of § 363(b) and further rejected its proposed basis in § 105(a). It would seem that the 7th circuit's approach has received application from the Florida Bankruptcy court in *In re Tropical Sportswear International Corporation* 320 B.R. 15 (Bankr. M.D. Fla. 2005). From an analysis of the case law, it would seem that the courts are far from agreement on this aspect. See further *In re Just for Feet, Inc* 242 B.R. 821 (Bankr. D.Del. 1999) per the *dictum* of McKelvie J at 825 where the motion for the payment of a 'critical vendor' was permitted. The court further exemplified § 105 as a modern day extension of the pre-Code doctrine of necessity.

¹⁰⁶⁶ McComack (2008) at 113.

¹⁰⁶⁷ McComack (2008) at 112.

¹⁰⁶⁸ See James J White 'Death and Resurrection of Secured Credit' (2004) 12 *American Bankruptcy Institute Law Review* 139.

¹⁰⁶⁹ Karen Gross 'A response to J.J. White's Death and Resurrection of Secured Credit: Finding Some Trees but Missing the Forest' (2004) 12 *American Bankruptcy Institute Law Review* 203 at 207.

Traditional secured lending... is asset based lending used by companies to obtain (among other things) relatively short-term monies for working capital. But, conventional secured lending is not always available, particularly for companies where their current and future wealth is found in their cash flow, not their hard assets. It is in this context that there has been enormous development in the bond market, particularly in the high yield debt market, and much of the high yield debt that is issued is unsecured. Specifically, the market size of the U.S. high yield market in 1978, the year before the Code went into effect was 26 billion USD. With some ups and downs, the market size of the U.S. high yield market in 1992 was 205 billion USD. In 2000, the market size of the U.S. high yield bond market was 668 billion USD...¹⁰⁷⁰

Gross proceeds to argue that the tenor of chapter 11 as it currently exists has not been due to Congressional intent but rather as a result of the interplay of market forces:

These developments occurred not because of [C]hapter 11; they occurred as a function of our capital markets and the development of those markets. They, indeed, have changed the nature of what occurs in [C]hapter 11 cases; again, however, that is not a change necessarily based on the role of secured creditors. So today, real [C]hapter 11 cases must deal with a vast array of new entities and new financial products that have matured or invented since the Code's enactment.¹⁰⁷¹

Debtor-in-possession financing arrangements have been applied as both a financing as well as a corporate governance mechanism by lender-creditors.¹⁰⁷² These creditors have been found to use their financial leverage in order to influence the manner in which managers and directors make their decisions during a bankruptcy.¹⁰⁷³

Examples are seen in loan schedules from DIP lenders containing specific dates on which the reorganisation plan is to be confirmed, with failure to meet timelines often being met by auctioning of company assets and calculated financial tightening.¹⁰⁷⁴ Even though this rise in creditor influence has been lauded on the basis that it has enabled faster proceedings, it has been criticised by some on the basis that bankruptcy has been converted into a quasi-liquidation process.¹⁰⁷⁵

The Commission to Study the Reform of Chapter 11 has raised concern regarding the potential consequences of certain conditions in loan covenants.¹⁰⁷⁶ In its recommendations on the reform of chapter 11, it has observed that condition carrying

¹⁰⁷⁰ Gross (2004) at 207.

¹⁰⁷¹ Gross (2004) at 208.

¹⁰⁷² Skeel (2003) at 917.

¹⁰⁷³ McComack (2008) at 113. For further reading on this aspect see Andrew B. Dawson 'Labour Activism in Bankruptcy' (2015) 89 *American Bankruptcy Law Journal* 97 at 105- 106.

¹⁰⁷⁴ McComack (2008) at 188.

¹⁰⁷⁵ McComack (2008) at 188; Douglas G Baird and Robert K Rasmussen 'The End of Bankruptcy' (2002) 55 *Stanford Law Review* 751 at 751-2.

¹⁰⁷⁶ American Bankruptcy Institute *Commission to Study the Reform of Chapter 11 (2012-2014)* (2014) available at www.abiworld.org accessed on 15 December 2015.

loan covenants¹⁰⁷⁷ often had a detrimental effect on the substantive efficiency of the chapter 11 process. The Commission found that while bankruptcy rules¹⁰⁷⁸ sought to ensure that affected parties had sufficient information prior to the hearing of a motion for the court to permit conditional financing, in many instances parties in interest either did not have sufficient time or information to evaluate the impact of such loans.¹⁰⁷⁹ It has been argued that because the U.S. envisages the debtor-in-possession approach, creditor lending agreements have been used as a measure to achieve, albeit indirectly, the creditor-in-possession approach seen in administration in the U.K.¹⁰⁸⁰

5.3.12.3. EMPLOYEE CREDITORS: WAGE CLAIMS

In addition to participation rights¹⁰⁸¹, the Code provides for payment of pre and post-petition wage claims, with differing levels of protection and a limited preference for pre-petition wage claims. The relevant provision in relation to pre-petition wages reads:

(a) The following expenses and claims have priority in the following order:

- ...
- (2) Fourth, allowed *unsecured claims*, but only to the extent of \$10,000 for each individual or corporation, as the case may be, earned within 180 days *before* the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for—
- (A) wages, salaries, or commissions, including vacation, severance and sick leave earned by an individual...¹⁰⁸²

Outstanding pre-petition wages are preferent over general unsecured claims. In order for this preference to apply, the wages must have been earned within a period no

¹⁰⁷⁷ These include conditions placing time periods within which the debtor's assets should be auctioned, concessions applicable to pre-petition financing arrangements, periods within which a disclosure statement and proposed plan must be filed as well as waivers applicable to surcharges.

¹⁰⁷⁸ Such as Bankruptcy Rule 4001(c).

¹⁰⁷⁹ American Bankruptcy Institute (2014) at 81. At 83 the Commission has recommended that bankruptcy courts should not approve such conditions within 60 days of the petition date or date of the order for relief (whichever is the later date), as part of the conditions of an approved interim order or where such conditions conflicted with a provision of the Code.

¹⁰⁸⁰ McComack (2008) at 190. McComack notes, regrettably, that such approach is without the controls one sees in a creditor oriented jurisdiction such as in the U.K.

¹⁰⁸¹ Chapter 11 provides creditors with participation rights during bankruptcy. A creditor falls within the definition of a 'party in interest' and the Bankruptcy Rules further provide employee unions with the right to participate in discussions or negotiations relating to a published plan of reorganisation where employees' rights are affected. The participation of employees may include a seat in a creditors committee, which must be appointed by the United States trustee once the petition has been filed. The committee generally consists of creditors who hold the largest claims against the debtor company. The committee's mandate includes consulting with the debtor company as well as investigating its financial position.

¹⁰⁸² My emphasis. § 507(a)(4)(A).

longer than 180 days before filing and is capped.¹⁰⁸³ Pre-petition wage claims may in exceptional circumstances be paid in priority to post-petition administrative expenses as a form of interim or final relief immediately following filing. The court must be approached for the purpose of authorising payments provided that the applicant is able to establish a prospect of immediate and irreparable harm should this not be done.¹⁰⁸⁴

There is provision for post-petition wages. This liability is categorised as an administrative expense and accorded preference:

...(b) After notice and hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including

...

(1)

(A) the actual, necessary costs and expenses of preserving the estate including—

(i) wages, salaries, and commission for services rendered *after commencement* of the case; and

(ii) wages and benefits pursuant to a judicial proceeding or a proceeding of the National Labour Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered...¹⁰⁸⁵

Resnick argues that in order to avert prejudice caused by a delay in payment, the debtor company can, on motion, request the court to authorise payment of pre-

¹⁰⁸³ This amount is capped at \$ 11 725(as at August 2012) per employee and is subject to adjustment every three years in terms of § 104(b). See <https://www.lexisnexis.com/legalnewsroom/bankruptcy/b/bankruptcy-law-blog/archive/2012/02/08/prebankruptcy-planning-related-to-employee-issues-and-claims.aspx> accessed on 28 June 2016. The American Bankruptcy Institute Commission at 93-94 has recommended a base aggregate cap of \$ 25 000 per employee for wage and benefit plan contributions. It has been recommended further that it not be necessary for the debtor to file its first day motion in order for the court to authorise payment of this amount as a priority payment in terms of section 507.

¹⁰⁸⁴ Rule 6003, Federal Rules of Bankruptcy Procedure. An administrative priority claim need not be paid up until the stage where the plan is to be confirmed. In this way there is a gap between priority in ranking versus immediacy of payment. See *Michigan Bureau of Workers' Disability Compensation v Chateaugay Corporation (In re Chateaugay Corporation)*, 80 B.R. 279, 286-7 (S.D.N.Y. 1987); *In re Gulf Air Incorporated*, 112 B.R 152, 153-4 (Bankr. W.D. La. 1989). However this is to be contrasted with the opposite approach of the courts in *In re FCX Incorporated*, 60 B.R. 405,411-12 (E.D.N.C. 1986); *In re Structurelite Plastics Corporation*, 86 B.R. 922, 932 (Bankr.S.D. Ohio 1988). On the use of the doctrine of necessity as a basis for payment of a pre-petition employee contract, see *In re Equalnet Communications Corporation* 258 B.R 368 (Bankr. S.D. Tex. 2001). A 'covered' employer is, in terms of the Worker Adjustment Retraining Notification Act (Warn Act 29 U.S. §§ 2101-2109) required to provide employees with sixty days advance notice prior to closing its plant or effecting mass retrenchments (11 U.S.C § 2102(a)). Where requisite notice has not been provided, employers may be liable for back pay and benefits, for each day in which notice has not been provided, to a maximum period of sixty days. See *In re Flexible Flyer Liquidating Trust*, 511 Fed. (5th Cir. 2013).

¹⁰⁸⁵ My emphasis, 11 U.S.C § 503(b)(1)(A).

petition wages in the ordinary course of business to the extent that such claims would have been granted priority by § 507(a)(4).¹⁰⁸⁶

The priority granted to employee claims arising in bankruptcy is justified on a number of bases.¹⁰⁸⁷ Unlike an ordinary trade creditor, the employee is viewed as unable to diversify its income and therefore cannot adequately mitigate its risk against an employer's failure to honour its wage obligations.¹⁰⁸⁸ In transacting with its employer, the employee does not factor the risk of the employer failing to make payment of wages as employees often accept employment even where they may not have sufficient (financially sensitive) information regarding the employer immediately.¹⁰⁸⁹ Even where information is available, employees may lack the mobility necessary to mitigate risks attendant upon an employer's bankruptcy. Further, the dependence of the bankrupt company on its workforce is cited as an incentive for ensuring that employee rights are protected where financial distress occurs and in order to and prevent high turnover when staff may be needed the most.¹⁰⁹⁰

5.3.12.4. BARGAINING AGREEMENTS

Employees, as a constituency, have an interest in the company being viable and financially stable. This interest extends to the expectation that wages will be paid by the employer when due, provision for employment benefits, continued future employment as well as informal understandings existing between employee and employer.¹⁰⁹¹

It has been argued that bankruptcy courts have often made concessions in favour of corporate rehabilitation at the expense of already won employee wage and benefits.¹⁰⁹² This may be attributed to the largely contractarian approach of the U.S. and stands in stark contrast to the approach observed in the U.K. Recent developments have seen a change in the prioritisation of existing collective bargaining agreements and less protections being provided to employees during bankruptcy.

¹⁰⁸⁶ Resnick (2005) at 193. The section has, however, not been used exclusively for the payment of wages and has included customer and warranty claims.

¹⁰⁸⁷ Donald R. Korobkin 'Employee Interests in Bankruptcy' (1996) 4 *American Bankruptcy Institute Law Review* 5 at 6.

¹⁰⁸⁸ Korobkin (1996) at 6.

¹⁰⁸⁹ Korobkin (1996) at 6. He refers to this as the ability to 'assume the risk' of the employer's default.

¹⁰⁹⁰ Korobkin (1996) at 6.

¹⁰⁹¹ Korobkin (1996) at 11.

¹⁰⁹² McComack (2008) at 211.

The National Labour Relations Act 1935¹⁰⁹³ provides that an employer may not make unilateral changes to the conditions of employment where a collective bargaining agreement has been entered into.¹⁰⁹⁴ The Act imposes a duty on the debtor company to engage in the process of bargaining negotiations first. Where a modification of employment conditions is contemplated, it must receive union consent.

The application of the National Labour Relations Act during bankruptcy has, however, been diluted by the Third Circuit in *NLRB v Bildisco*.¹⁰⁹⁵ In brief, the facts of the case are as follows: In April 1980 the respondent filed for bankruptcy, having previously entered into a collective bargaining agreement with its workers' union. This agreement was due to expire in 1982.

The respondent breached the agreement by, amongst other things, the failure to pay health and pension benefits, remit union fees and increase wages. It sought leave from the bankruptcy court to cancel the agreement and the union was granted a period of 30 days in which to file its claim for damages. The court of appeal found no evidence that collective bargaining agreements were intended to be excluded from the scope of § 365.¹⁰⁹⁶ Having observed that collective bargaining agreements in terms of the Railway Labor Act were specifically excluded from the provision's ambit, it was the court's view that the inference was that Congress did not intend to distinguish between collective bargaining agreements and executory contracts in general.¹⁰⁹⁷

Acknowledging that a collective bargaining agreement, while capable of being rejected, was a different pedigree of contract, the court (citing the *ratio* of the earlier *Kevin Steel matter*¹⁰⁹⁸ with approval) articulated the test for rejection thus:

The second circuit in *Kevin Steel*, speaking through judge Feinberg, accommodated the interests of the workers by holding that rejection of a collective bargaining agreement requires "thorough scrutiny, and a careful balancing of equities on both sides"...We accept this formulation of the appropriate relationship between the competing statutory policies. It accommodates the statutory policies of the Labor Act by demanding a greater evidentiary showing than for a typical executory contract, but does not erect impossible barriers to rejection of labor contracts in violation of the policies underlying Chapter 11. It plots a middle course between the possible extremes, requiring

¹⁰⁹³ The National Labour Relations Act 1935 (49 Statute 449) 29 U.S.C § 151-169.

¹⁰⁹⁴ (NLRA) at U.S.C § 158(a)(5).

¹⁰⁹⁵ *In re Bildisco* US Court of Appeals for the Third Circuit- 682 F. 2d 72 (3d Cir. 1982).

¹⁰⁹⁶ *In re Bildisco supra* at 79.

¹⁰⁹⁷ *In re Bildisco supra* at 79.

¹⁰⁹⁸ *Shopmen's Local Union No. 455 v Kevin Steel Prods., Inc* 519 F.2d 698 (2d Cir. 1975) this case had in turn cited *In Re Overseas National Airways, Inc.*, 238 F Supp. 359 (E.D.N.Y. 1965) with approval.

a sensitive weighing of the competing private and public interests in the context of the particular case.¹⁰⁹⁹

The debtor may reject a collective bargaining agreement if the bankruptcy court finds that the agreement burdens the estate and where the equities are balanced in favour of its rejection.¹¹⁰⁰ When approaching the court for the purpose of rejecting a collective bargaining agreement, it is sufficient for the debtor to show that the rejection will be in the best interests of the estate and its creditors.¹¹⁰¹ Before sanctioning the rejection the court is required to satisfy itself that having received the proposal, the union in question opposed it 'without good cause'.¹¹⁰²

The approach taken by the court in *Bildisco* lends credence to the view that the law is often rigid and due to this, it may sometimes create inefficiencies that run contrary to the objectives of rescuing a struggling business. It may have been a view on the part of the court that every affected creditor, including employees, has to 'chip-in' and take a cut in the interests of the company's future.¹¹⁰³ This view, it is submitted, seems to find support in the court's affirmation of the earlier *Kevin Steel case*¹¹⁰⁴ and rejection of the approach in the subsequent *REA Express*¹¹⁰⁵ matter.¹¹⁰⁶

The Congressional response to was to introduce § 1113, which bars the debtor from cancelling or modifying a bargaining agreement without a bankruptcy court

¹⁰⁹⁹ *In re Bildisco supra* at 80.

¹¹⁰⁰ *In re Bildisco supra* at 82. The courts have articulated a nine-step procedure to determine whether a collective bargaining agreement should be rejected, See *In Re American Provision Co* (1984) 44 BR 907 (Bankr. D. Minn. 1984). A 'balancing of equities' includes an analysis of employees not protected by the collective bargaining agreement, the possible effect of the failure to reorganise as well as the timing of the rejection or request for modification of the proposal. For further reading, see S Becker 'Bankruptcy Law's Effect on Collective Bargaining Agreements' (1981) 81 *Columbia Law Review* 391 at 402-3. The court in *In Re Mile Hi Systems, Inc.*, 889 F.2d 887, 892 (10th Cir. 1990), recognising the necessity for public policies seeking to prevent unfair labour practices, emphasised the importance of chapter 11 in preventing debtor liquidation with attendant job losses. This, in the view of the court, justified interpreting labor laws in a manner that takes account of policies of the Code.

¹¹⁰¹ Conversely, the debtor must demonstrate that the continuation of the agreement will burden the estate; see *In re Bildisco supra* at 82. The debtor is required to have acted in good faith in coming to this conclusion in terms of § 1113(b)(2). See Mark S Pulliam 'Rejection of Collective Bargaining Agreements under Section 365 of the Bankruptcy Code' (1984) 58 *American Bankruptcy Law Journal* 1 and the cases cited therein.

¹¹⁰² See *Bildisco supra* and § 1113(c)(2). George S. Roukis & Bruce H. Charnov 'NLRB v Bildisco and Bildisco and the Legislative Aftermath: A New Frontier for Arbitrators?' (1986) 41(2) *The Arbitration Journal* at 46.

¹¹⁰³ *Bildisco supra* at 80; See the judgment of the Court of Appeals in the earlier *Brotherhood of Railway Employees v REA Express, Inc* 523 F.2d 164 *infra*.

¹¹⁰⁴ *Shopmen's Local Union No. 455 v Kevin Steel Prods., Inc supra*.

¹¹⁰⁵ *Brotherhood of Railway, Airline and Steamship Clerks v REA Express, Inc* 523 F.2d 164 (2d Cir. 1975).

¹¹⁰⁶ See *Bildisco supra* at 80-81.

adjudicating on the matter first.¹¹⁰⁷ Therefore instead of overruling this case, Congress introduced standards intended to regulate its application.¹¹⁰⁸

Should the court fail to rule on the application for rejection within thirty days, the debtor may unilaterally amend or cancel the terms of the bargaining agreement pending adjudication.¹¹⁰⁹ Sirianni observes that the introduction of § 1113 has served to create checks and balances on debtor employers desiring to indiscriminately reject employment contracts.¹¹¹⁰

Congressional amendments have seen application in more recent matters, where the courts have affirmed that although § 1113(c) referred only to requirements relating to rejection, the same would apply within the context of modifications.¹¹¹¹ The debtor bears the onus of proving that the nine requirements of the provision are satisfied.¹¹¹²

In *Hostess II*¹¹¹³ the court granted a motion sought by the debtor for the rejection of its collective bargaining agreement, which meant that the worker's union¹¹¹⁴ was left without a collective bargaining agreement in place.¹¹¹⁵ Due to the effect of continuous acrimony between the debtor and the Baker's union (continuous strikes) on approved loan covenant conditions and the failure of mediation between both parties, an order for the winding up of the company was ultimately granted.¹¹¹⁶

¹¹⁰⁷ 11 U.S.C § 1113(e) & (f). Introduced by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353. 98 Stat 333 (1984). The history of this section is discussed in *In re Royal Composing Room, Inc.*, 848 F.2d 345, 352-354 (2nd Cir. 1988).

¹¹⁰⁸ See *In re Fiberglass Indus., Inc.*, 49 B.R. 202, 203 (Bankr. N. D. N. Y. 1985); *International Brotherhood of Teamsters v IML Freight, Inc.*, 789 F.2d 1460 (10th Cir. 1986).

¹¹⁰⁹ 11 U.S.C § 1113(d)(2).

¹¹¹⁰ Sirianni (1987) at 444. This provision received interpretation from the court in *Wheeling- Pittsburg Steel Corporation v United Steelworkers* 791 F. 2d 1074 (3d Cir. 1986).

¹¹¹¹ *In re Garofalo's Finer Foods, Inc.*, 117 B.R 363, 369 (Bankr. N.D. Illinois 1990) at 370. See *In re Northwest Airlines Corp.*, 483 F.3d 160 (2d Cir. 2007) at paras 38 & 39; *In re Walter Energy Inc.* 542 B.R. 859 (Bankr. N.D. Ala. 2015); *In re Trump Entertainment Resorts* 810 F.3d 161 (3rd Cir. 2016) the Court of Appeals confirmed that § 1113 finds application within the context of both expired and unexpired CBAs (Collective Bargaining Agreements).

¹¹¹² *In re Garofalo's Finer Foods supra* at 369. The court affirmed the approach of the earlier *In re Walway Co.*, 69 B.R. 967 (Bankr.E.D.Mich.1987); *In re National Forge Co.*, 279 B.R. 493, 500 (Bankr.D.Del. 2002).

¹¹¹³ *In re OLD HB, Inc. (f/k/a Hostess Brands, Inc.), et al.*, Case No. 12-22052 (Bankr. S.D.N.Y. Jan 11 2012).

¹¹¹⁴ The Bakery, Confectionary, Tobacco Workers and Grain Millers International Union hereinafter the 'Baker's union.'

¹¹¹⁵ However, its motion to reject the terms of its collective bargaining agreement with the second union, the International Brotherhood of Teamsters, was denied with leave to amend the motion having being granted.

¹¹¹⁶ The order was granted in terms of §§ 105, 363, 365 and 503(c) of the Bankruptcy Code.

The rejection of an existing collective bargaining agreement was a success in *American Airlines*¹¹¹⁷ and resulted in the emergence of a merged entity.

Roukis and Charnov argue that even though the *Bildisco* decision has done very little to further promote labour peace or company survival, it has presented new opportunities for labour arbitration. They observe that there existed a fundamental conflict between the labour legislation and Bankruptcy Amendment Acts, with this conflict having been resolved in favour of management.¹¹¹⁸

Pulliam in turn observes that the court in *Bildisco* may be commended on the basis that it drew a line in relation to the progressive non-interpretive approach to the standard to be applied where a collective bargaining agreement is in question. He however criticises the judgment on the basis that the line was drawn in the wrong place and ignored an array of case authority which seemed, from an interpretive perspective, consistent with the language and structure of the scheme of bankruptcy.¹¹¹⁹ The rejection of collective bargaining agreements, within strictly prescribed parameters, may serve to provide the debtor with necessary breathing space (and more importantly, liquidity) needed to enable it to sail out of insolvency. The treatment of dissenting creditors is discussed next.

5.3.13. DISSENTING CREDITORS

The Code allows for a ‘cram-down’ of an objecting class of creditors in certain instances. A class of creditors may be forced to go along with the plan despite rejection.¹¹²⁰ The applicable provision reads:

...(b)

(1) Notwithstanding section 510 (a) of this title, if all of the applicable requirements of subsection (a) of this section *other than paragraph (8)* are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirement of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan...¹¹²¹

¹¹¹⁷ *In re AMR Corp., et al.*, Case No. 11-15463 (Bankr. S.D.N.Y, Nov. 29 2011). The debtor merged with U.S. Airways.

¹¹¹⁸ Roukis & Charnov (1986) at 44. With applicable provisions being section 8(d) of the National Labour Relations Act Public Law No. 198, 49 Stat. 449 (of 1935), as amended and 11 U.S.C § 365(a).

¹¹¹⁹ Pulliam (1984) at 31.

¹¹²⁰ Westbrook in Rajak (1993) at 362.

¹¹²¹ My emphasis. § 1129(b)(1). The Code contemplates 16 requirements to be satisfied for the plan’s confirmation. Paragraph 8 of § 1129(a) requires, as a condition, that each class of impaired claims or interests must accept the plan.

Even though dissenting classes may be subject to a ‘cram-down’, they remain protected. The plan must treat similarly placed creditors comparably (the rule against unfair discrimination) and it must be fair and equitable.¹¹²² The fair and equitable standard requires that the plan not impose an unreasonable risk on the secured creditor for potential plan failure.¹¹²³

For dissenting secured creditors, an additional set of criteria finds application and contemplates one of three requirements. The plan may provide for a secured creditor to retain its security (with the debtor transferring or retaining the collateral) while allowing it to receive cash deferred payments.¹¹²⁴ The deferred cash payments must aggregate to at least the amount of the allowed secured claim and are required to have a present value equivalent to the collateral.¹¹²⁵ Collateral may be sold free of the security interest, with the security interest attaching to the proceeds of the sold collateral.¹¹²⁶ In the alternative, the plan may provide for an ‘indubitable equivalent’ of the secured creditor’s claim.¹¹²⁷

5.3.14. EXIT AND DISCHARGE

Once the plan has been confirmed, its provisions bind the following categories of persons:

...the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity holder or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan...¹¹²⁸

In addition, the debtor company is discharged from its debts whether or not a creditor, equity or security holder or partner accepted the plan.¹¹²⁹ Discharge applies in respect of pre-petition creditor claims and includes claims which were either not filed or deemed filed as well as those which were not accepted.¹¹³⁰

¹¹²² § 1129(b)(1) & (2).

¹¹²³ § 1129(b)(2)(A).

¹¹²⁴ 11 U.S.C § 1129(b)(2)(A)(i).

¹¹²⁵ § 1129(b)(2)(A)(i). In this regard § 1111(b)(2) may find application. Benjamin Weintraub & Alan Resnick *Bankruptcy Law Manual* (3rd ed) (1992) Warren, Gorham & Lamont: New York at 8-138.

¹¹²⁶ 11 U.S.C § 1129(b)(2)(A)(ii).

¹¹²⁷ 11 U.S.C § 1129(b)(2)(A)(iii).

¹¹²⁸ 11 U.S.C § 1141(a).

¹¹²⁹ Unless otherwise stipulated, § 1141(a) & (c). Further exceptions to discharge are contained in § 1141(d)(6).

¹¹³⁰ 11 U.S.C § 1141(d).

5.3.15. OBSERVATIONS

A number of factors have been attributed to the perceived success of bankruptcy proceedings in practice. These have touched upon the Code's theoretical underpinnings as well as the regime's emphasis on practicality.

The Bankruptcy Code does not require a company desiring to avail itself of the benefits of chapter 11 proceedings to be factually or commercially insolvent. It is sufficient for the company to have filed its petition in good faith and have a reorganisation purpose. With the procedure being substantively court oriented, the courts are often best positioned to determine whether the good faith requirement has been satisfied by a petitioner. A combination of the above permits a level of flexibility in terms of accessing the procedure.

Once proceedings have commenced the debtor is able to derive the benefit of the application of a moratorium against claims. Directors and management of the company remain in control unless exceptional circumstances warrant the appointment of an examiner or trustee to displace management. It is for this reason that the regime is referred to as that of the debtor-in-possession.

This approach has received justification on a number of bases including the view that management, having a deeper knowledge and understanding of business operations, is best placed to sail the company out of the perilous waters of financial difficulty (with the obvious benefit in the form of relief from creditor enforcement). A related observation is that unlike comparative jurisdictions, the Code does not contain specific provisions regulating wrongful conduct on the part of directors. Control over director conduct remains regulated by directors' fiduciary duties, which are of common law origin. It has been argued that this approach provides an additional incentive for directors to access proceedings as soon as signs of distress appear, thus increasing the intervention's chances of success.

When the corporation enters bankruptcy, there is a shift in fiduciary duties from the duty of directors and managers to act in the best interests of the corporation (i.e. in the interests of its stockholders) to the debtor-in-possession's duty to act in the interests of its creditors.¹¹³¹ Upon bankruptcy, it is the creditors who replace shareholders as residual risk bearers.¹¹³²

¹¹³¹ Florence Shu-Acquaye 'American Corporate Law: Directors' Fiduciary Duties and Liability During Solvency, Insolvency, and Bankruptcy in Public Corporations' (2011) *University of Puerto Rico Business Law Journal* Vo 2(1) 1. The commentator observes that the Delaware Court of

The court-oriented procedure plays an important role in mediating between the interests of the debtor, in terms of ensuring a procedural environment conducive to company reorganisation, as well as those of its creditors. Bankruptcy courts therefore serve as an important mechanism for placing controls on potentially self-serving behaviour on the part of the debtor's management.

The procedure is characterised by an emphasis on creditor participation. This occurs through creditor committees (both official as well as unofficial),¹¹³³ the purpose of which is to ensure that the position of creditors is clearly articulated during proceedings. The views of creditor committees become an important consideration when plan confirmation is sought from the bankruptcy court. In addition to participation rights, the committee of creditors (or parties in interest) is entitled to all necessary information regarding the debtor.

The existence of bankruptcy courts is highlighted as an aspect which has enhanced the efficiency of the procedure. It has been argued that specialised courts contribute to the creation of sophisticated centres of excellence where judges possess many years of experience, often having previously practiced as bankruptcy lawyers.¹¹³⁴ The inherently practical nature of proceedings and the proactive approach of bankruptcy courts have been observed as effective in addressing and adapting to often unpredictable economic circumstances. This has been evidenced in the procedure allowing multiple-tiered special purpose vehicles, which may have been designed to be theoretically bankruptcy-remote, to access proceedings, introduction of 'roll-ups' to encourage pre-existing lenders to advance further lending to the debtor, sufficient flexibility for the company to pay certain vendors whose products or services are critical for the running of the company, pre-packaged deals, and permitting asset sales at an early stage provided that certain requirements are met.

Chancery has charted significant ground in this area of the law, having over 200 years of legal precedent as a maker of U.S. corporation law. See *North American Catholic Education Programming Foundation, Inc. v. Gheewalla*, 930 A. 2d 92 (Del. 2007). The court at 102-103 opined that during insolvency, a creditor cannot bring a breach of fiduciary action to recover individually (i.e. directly) but that a derivative claim on behalf of the corporation could be brought in such case. Compare with earlier matters: *Credit Lyonnais Bank Nederland N.V. v. Pathe Commc'ns Corp.*, Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. 1991); *Geyer v Ingersoll Publications Company* 621 A.2d 784 (1992).

¹¹³² Shu-Acquaye (2011) at 11 and 14.

¹¹³³ 11 U.S.C § 1102(a)(1). The committee may further file a proposed plan of reorganisation once the exclusivity period has elapsed, see 11 U.S.C § 1121(c).

¹¹³⁴ Philip Mindlin *Presentation to the Company Law Symposium organized by The South African Department of Trade and Industry & The Specialist Committee on Company Law* (1 March 2013) available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf.

Chapter 11 makes provision for super-priority ranking of post-petition financing. This mechanism is used to encourage lenders to advance finance to the debtor company with the confidence that their monies will be paid in priority to pre-petition unsecured and secured creditors as well as post-petition administrative expenses. Should the debtor subsequently be liquidated, the superior ranking endures.

Bankruptcy provides the debtor with the opportunity to propose a plan for the future of the company during the exclusivity period, to accept or reject executory contracts and to engage in the sale of company assets with or without the court's approval (provided that certain requirements are met). The debtor is further permitted to negotiate outside of bankruptcy as evidenced through work-outs as well as pre-packaged deals. Creditors may propose competing plans where the exclusivity period has expired without extension or where the plan has not been approved, which places pressure on the debtor to present a plan which results in a better outcome for creditors. Once the disclosure statement has received approval from the court and after considering any creditor objections to the adequacy of the disclosure statement, the plan is voted upon by creditors. Once adopted, it must be confirmed by court.¹¹³⁵

Creditor ascendancy has received the attention of commentators who have observed its growth in bankruptcy. The market for distressed debt has been said to contribute to expedited proceedings, with lenders applying contractual mechanisms as corporate governance levers. The rise of bankruptcy investment allows for smaller creditors to sell their claims to experienced debt traders and avert the risk attendant upon participating in proceedings.

The Code provides protection for creditors through the application of concepts such as 'adequate protection', 'absolute priority' and the 'fair and equitable' principle among others. Despite these, in exceptional circumstances, it permits a cram-down of dissenting classes and allows approval of the proposed plan by the courts even in the face of creditor rejection.

Due to the development of case law and subsequent statutory amendments, employee bargaining agreements may be amended or rejected during chapter 11 proceedings. This has resulted in a dilution of protection for employees but has been justified on the basis that the efficacy of a rescue intervention often requires a

¹¹³⁵ As required by 11 U.S.C § 1128 & 1129(a). The purpose of this exercise is for the court to verify that certain information which was necessary to enable creditors to make a decision on the plan, is/was in fact incorporated.

compromise on the part of each creditor in order to ensure business continuity. Some commentators have argued that corporate rehabilitation has been at the expense of hard won employee gains. Therefore, the treatment of employee creditors may be described as involving a ‘mixed bag of compromises’ between continued employment and continued survival of the entity.

Provision is made for both pre and post-petition wage claims. While pre-petition claims are capped in respect of claim period and amount, post-petition wage claims are characterised as an administration expense and granted priority over general unsecured claims. Even though post-petition wage claims are granted this status, it may be of a lower ranking in relation to post-petition financing. This approach strikes an appropriate balance between the need to retain human capital for the continued operation of the company and much needed financial capital for the continued survival of the entity enabling it to achieve reorganisation.

The advent of a plan’s confirmation and the discharge of debt present an opportunity for third party investors to acquire the business free of liability and onerous contractual obligations. This creates the necessary conditions for, at minimum, the survival of the business as a going concern. In addition, the Code provides for the reversal of certain transactions entered into which may have resulted in the debtor enduring undue financial hardship.

Despite the strengths of the procedure, some of which have received discussion, a number of criticisms have been levelled and these are by no means exhaustive. It has been argued that the relative ease with which a debtor can access proceedings has resulted in ‘bankruptcy arbitrage’ or forum shopping where debtors file in particular jurisdictions specifically to derive outcomes which may not have materialised had they filed elsewhere.¹¹³⁶

The court orientation of proceedings has contributed to the perceived expensiveness of proceedings, often characterised by the need for both financial advisors as well as lawyers who often charge exorbitant fees. It has been observed by some that this factor has made bankruptcy inaccessible for smaller enterprises due to being financially prohibitory. The Commission to Study the Reform of Chapter 11 has highlighted the potentially prohibitory nature of bankruptcy proceedings for small

¹¹³⁶ See generally Omer Kimhi & Arno Doeberst ‘Bankruptcy Law as a Balancing System: Lessons from a Comparative Analysis of the Intersections Between Labor and Bankruptcy Laws’ (2015) 23 *American Bankruptcy Institute Law Review* 491.

to medium sized enterprises as one of the factors which have sparked the need to consider potential reform of the U.S. Bankruptcy system.¹¹³⁷

Commentators such as Lubben have argued that fees in a bankruptcy are in fact determined by aspects such the complexity of the matter.¹¹³⁸ Even though legislative amendments in the form of the Bankruptcy Abuse Prevention and Consumer Protection Act have contributed to expedited proceedings by imposing limitations on the exclusivity period, some have argued that this has resulted in refilings due to the debtor not having been given sufficient time to engage in a proper restructuring of its affairs.¹¹³⁹

5.4 UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW

This part of the thesis proceeds to briefly consider international best practice models on corporate insolvency. Of particular relevance are the recommendations of the United Nations Commission on International Trade Law (UNCITRAL) in the form of the *UNCITRAL Legislative Guide on Insolvency Law*¹¹⁴⁰, which may be accepted as an authoritative source on insolvency law and corporate rescue in the international law domain.

Before delving into its content, it is appropriate to contextualise UNCITRAL as part of a broader organisational framework as well as to highlight methods employed by the Commission to influence legislative developments within the international terrain. The United Nations Commission on International Trade Law (UNCITRAL) was established on the 17 December 1966.¹¹⁴¹ The purpose of the Commission is to facilitate both harmonisation and modernisation of international

¹¹³⁷ American Bankruptcy Institute (2014) at 10 & 58.

¹¹³⁸ Stephen J. Lubben 'Corporate Reorganization & Professional Fees' (2008) 82 *Am. Bankr. L.J.* 77 at 79–80; Stephen J. Lubben, 'What We "Know" About Chapter 11 Cost is Wrong' (2012) 17 *Fordham J. Corp. & Fin. L.* 1. For analysis of fees charged in relation to large reorganization cases, see Lynn M. Lo Pucki & Joseph W. Doherty 'The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases' (2014) 1 *J. Empirical Legal Stud* 111 at 140.

¹¹³⁹ Foteini Teloni (2015) at 591. A related aspect observed has been the rise of § 363 asset sales.

¹¹⁴⁰ *UNCITRAL Legislative Guide on Insolvency Law* (United Nations, 2005) available at https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf accessed 19 September 2016. The text was adopted by General Assembly 59/40 of 2 December 2004.

¹¹⁴¹ In terms of the United Nations General Assembly resolution 2205 (XXI). See *UNCITRAL A Guide to UNCITRAL Basic facts about the United Nations Commission on International Trade Law* (United Nations, 2013) information available at <http://www.uncitral.org/pdf/english/texts/general/12-57491-Guide-to-UNCITRAL-e.pdf> accessed on 19 September 2016.

trade through the development of a legal framework (through legislative and non-legislative instruments).¹¹⁴²

South Africa was listed as a UNCITRAL member State during 2004- 2013, this being squarely within the period in which the South African company law reform process commenced.¹¹⁴³ The commission employs the use of three forms of legislative texts consisting of conventions, legislative guides and model provisions.¹¹⁴⁴ In broad, the following distinctions may be observed in relation to these forms: The objective of a convention is to unify the law by creating binding legal obligations between participating States.¹¹⁴⁵ As a consequence, the law of the participating State is, at minimum, required to be consistent with the content of the adopted convention.¹¹⁴⁶

A model law is a legal text recommended for enactment in an adopting State's domestic law, providing sufficient flexibility for its adjustment in order to contend with domestic requirements which may vary between States.¹¹⁴⁷ Legislative guides provide an alternative where it is not always possible or convenient to draft uniform provisions in the form of a convention or model law. In this way, a legislative guide functions as a uniform text, the content of which proposes either a set of principles or legislative recommendations.¹¹⁴⁸ Legislative guides are often applied by governments as a standard by which they review the content or sufficiency of their existing legislation.¹¹⁴⁹ Having briefly discussed UNCITRAL and the international instruments applied to influence and uniformise legislation (from an international perspective), I turn to an analysis of the relevant provisions of the *Legislative Guide on Insolvency Law*.

In its introduction, the guide articulates the objective of an effective insolvency system in the following:

When a debtor is unable to pay its debts and other liabilities as they become due, most legal systems provide a mechanism to address the collective satisfaction of outstanding claims from assets (whether tangible or intangible) of the debtor. A range of interests needs to be accommodated by that mechanism: those of the parties affected by the proceedings including the

¹¹⁴² UNCITRAL (2013) at 1.

¹¹⁴³ UNCITRAL (2013) at 2 read with Annexure II. The South African Department of International Relations, however, cites South African membership as having been during the periods 2007-2013. The latter information is available at <http://www.suedafrika-botschaft.at/en/international-relations/multilateral-relations/united-nations-commission-on-international-trade-law-uncitral.html> accessed on 28 February 2017.

¹¹⁴⁴ UNCITRAL (2013) at 13.

¹¹⁴⁵ UNCITRAL (2013) at 13.

¹¹⁴⁶ UNCITRAL (2013) at 13.

¹¹⁴⁷ UNCITRAL (2013) at 14.

¹¹⁴⁸ UNCITRAL (2013) at 16.

¹¹⁴⁹ UNCITRAL (2013) at 16.

debtor, the owners and management of the debtor, the creditors who may be secured to varying degrees (including tax agencies and other government creditors), employees, guarantors of debt and suppliers of goods and services, as well as the legal, commercial and social institutions and practices that are relevant to the design of insolvency law and required for its operation. Generally, the mechanism must strike a balance not only between the different interests of these stakeholders but also between these interests and the relevant social, political and other policy considerations that have an impact on the economic and legal goals of insolvency proceedings...¹¹⁵⁰

The guide provides a set of key objectives regarding the proposed structure for an efficient system of insolvency law. These include the ability of the proceedings to maximise the value of assets in order to facilitate higher distributions for creditors and reduce the cost of insolvency while maintaining a balance between liquidation and reorganisation, treating similarly placed creditors equally, providing for timely and impartial resolution of insolvency, preserving the estate to enable equitable distribution, recognising pre-existing contractual rights and designating a clear ranking of claims.¹¹⁵¹

The ability of a regime to maximise the value of assets occurs through a framework which permits the setting aside or avoidance of pre-commencement transactions in certain circumstances in order to ensure equitable treatment between creditors.¹¹⁵² The balance between liquidation and reorganisation entails an analysis of potential advantages to be derived from liquidation (which may accrue to secured and preferent shareholders) versus reorganisation (which may accrue to unsecured creditors).¹¹⁵³ Where reorganisation is viewed as desirable from a social policy perspective, it ought not to involuntarily reduce the proposed dividend for creditors to below an amount which they would have received in liquidation.¹¹⁵⁴

¹¹⁵⁰ UNCITRAL (2005) at 9. It is to be observed that in the glossary section, ‘Insolvency proceedings’ are defined as ‘collective proceedings, subject to court supervision, either for reorganization or liquidation’. The guide further acknowledges that even though it assumes the existence of court supervision throughout proceedings, such reliance ought to be taken as a general principle rather than as a prescriptive position. Within the guide’s context, proceedings include corporate/business rescue whether through a court oriented regime or not. Therefore in this part of the thesis, the word ‘insolvency’ is a broad reference to describe a company’s inability to pay its debts where due and ‘insolvency proceedings’ may include liquidation or business rescue. Further, references to ‘insolvency law’ in this part are to be read as references to company law unless otherwise specifically stated, as our rescue regime resides in a company rather than an insolvency statute.

¹¹⁵¹ UNCITRAL (2005) at 10-13.

¹¹⁵² UNCITRAL (2005) at 10. It has been observed that both U.K. and U.S. insolvency procedures provide a framework for avoidance of certain pre-bankruptcy transactions.

¹¹⁵³ UNCITRAL (2005) at 11.

¹¹⁵⁴ UNCITRAL (2005) at 11.

Equal treatment of similarly placed creditors requires that creditors whose claims are in the same class should not be unfairly discriminated against.¹¹⁵⁵ Timely and impartial resolution of insolvency entails that proceedings are completed expeditiously so as not to disrupt the debtor's business activities.¹¹⁵⁶ This ensures that the cost factor is minimised and entails distinguishing between viable and non-viable businesses, implementing interventions focused on rescuing the former and liquidating the latter.¹¹⁵⁷

Recognising and enforcing certain pre-commencement rights that creditors have in relation to the debtor creates certainty in the market and enhances the latter's ability to access further credit.¹¹⁵⁸ Due to the voluminous and comprehensive nature of the guide, for our purposes the discussion is limited to a discussion of the following: access to the procedure, the moratorium, post-commencement finance, pre-existing (labour) contracts, transaction avoidance upon commencement, ranking of claims and post-adoption plan amendment.

A commencement standard which is transparent, flexible and certain encourages access to the procedure.¹¹⁵⁹ This is qualified by the need for safeguards which ensure that the procedure is not used improperly by companies which are not in financial distress so as to benefit from the moratorium and aim to avoid or delay having to pay creditors.¹¹⁶⁰ This element is to be understood within the context of a properly functioning institutional framework with sufficient capacity to either adjudicate the insolvency process or regulate the manner in which some or all participants conduct themselves during proceedings.¹¹⁶¹

An automatic moratorium on enforcement action is considered essential for the preservation of property belonging to the insolvent estate, curtails the diminution of a debtor's assets and allows for proper administration.¹¹⁶² Post-commencement

¹¹⁵⁵ UNCITRAL (2005) at 11. Chapter 11 specifically provides for this in provisions regulating confirmation of the plan in § 1129. This aspect is also strictly regulated by the Insolvency Act 1986.

¹¹⁵⁶ UNCITRAL (2005) at 12. This includes a framework for asset recovery and collections to enable the debtor to satisfy its debts as well as facilitating participation between the debtor and its creditors in a manner that reduces delay and expense.

¹¹⁵⁷ UNCITRAL (2005) at 12.

¹¹⁵⁸ UNCITRAL (2005) at 13.

¹¹⁵⁹ UNCITRAL (2005) at 45.

¹¹⁶⁰ UNCITRAL (2005) at 45.

¹¹⁶¹ UNCITRAL (2005) at 33-35. In this regard, capacity becomes an important factor. The institutional framework may include courts whose function is to play a supervising role (as seen in jurisdictions such as the U.S.) or through vesting powers on a regulatory authority which monitors the process (as in South Africa).

¹¹⁶² UNCITRAL (2005) at 83.

finance is essential to the success of any rescue intervention, especially where reorganisation is envisaged. In this way, access to liquid funds, whether in the form of cash, existing cash-flow or assets that can be converted into cash, becomes important.¹¹⁶³ Where the business does not have access to cash resources, it may have to seek this from third parties. Importantly, the guide acknowledges that financing may be through lenders or extension of trade credit by vendors.¹¹⁶⁴ While sourcing the requisite finance, the need to protect pre-existing secured interests is emphasised.¹¹⁶⁵

It is observed that priority ranking is often based on socio-economic concerns which may be better dealt with outside of insolvency law.¹¹⁶⁶ The problem with factoring in such concerns is that the law dealing with the insolvency of a debtor provides an inadequate solution to social problems as its direct concern is the question of debt and the debtor's financial situation.¹¹⁶⁷ Additionally, it may render an insolvency (rescue) regime less efficient.¹¹⁶⁸

While highlighting concerns regarding a strong emphasis on social welfare objectives in insolvency, in relation to the treatment of employee claims, the guide provides an endorsement for differential treatment:

...In a number of cases [employee claims] rank higher than most other priority claims, specifically tax and social security claims, and in a few cases, as noted above, above secured claims. The approach of providing priority for workers' claims is generally consistent with the special protection that is afforded to employees in other areas of insolvency law, as well as with the approach of international treaties on protection of workers. In some insolvency laws, the importance of maintaining continuity of employment in priority to other objectives of insolvency proceedings...is evidenced by a focus on the sale of the business as a going concern (with the transfer of existing employment obligations), as opposed to liquidation or reorganization where these obligations may be altered or terminated.¹¹⁶⁹

The guide suggests that employee claims may be ranked in a variety of ways; for instance, in priority to tax and social security claims or equally with such claims or (in some cases) above secured claims.¹¹⁷⁰ In other instances employees may be ranked

¹¹⁶³ UNCITRAL (2005) at 113.

¹¹⁶⁴ UNCITRAL (2005) at 114. The thesis has that argued that one of the critical short-comings of post-commencement finance provisions in Chapter 6 is the apparent limitation to monies extended by lenders (in addition to post-commencement outstanding remuneration claims). This seems to arbitrarily exclude vendors who may have extended a critical supply of trade credit of goods to the debtor.

¹¹⁶⁵ UNCITRAL (2005) at 115. This approach is similar to chapter 11, specifically with the concept of 'adequate protection' for pre-existing creditor interests.

¹¹⁶⁶ UNCITRAL (2005) at 271.

¹¹⁶⁷ UNCITRAL (2005) at 271.

¹¹⁶⁸ UNCITRAL (2005) at 271.

¹¹⁶⁹ UNCITRAL (2005) at 272. For further reading on guidelines dealing with the protection of employee claims within the international context, see International Labour Organization (ILO) *Protection of Workers' Claims (Employer's Insolvency) Convention of 1992 (No. 173)*, Article 8.

¹¹⁷⁰ UNCITRAL (2005) at 272.

with ordinary concurrent claims (with or without a State guarantee or insurance fund settling a specified portion of the claim).¹¹⁷¹ Where an insurance or guarantee fund settles a portion, subrogation occurs, with the relevant fund assuming the claim of the employee.¹¹⁷²

Irrespective of treatment, the claim of employees is largely seen as an exception to criticism of ordinary priority claims whose objective is simply to advance socio-welfare objectives. There seems to be some international consensus that employees, whose pedigree of claim is ordinarily unsecured, cannot be treated in the same manner as other creditors holding a similar type of claim. It is only in relation to the extent of preference/ differential treatment where States largely differ.

Contracts are an important part of economic reality, playing a role both in and outside the context of company insolvency. As a result, and in pursuance of the maximisation of the insolvent estate (whether through liquidation or reorganisation), the power to take advantage of beneficial contracts and reject prejudicial ones is critical.¹¹⁷³

An impending insolvency may provide an opportunity for the debtor to attempt to hide assets from its creditors or provide a preference to certain categories of creditors, which may be to the detriment of the general body.¹¹⁷⁴ This may occur through an actual disposal of assets or the incurring of obligations which result in encumbrance.¹¹⁷⁵ The substance of such transactions results in a reduction of the net worth of the debtor.¹¹⁷⁶ The benefits of a regime that permits avoidance of such transactions are thus stated:

... Provisions dealing with avoidance powers are designed to support these collective goals, ensuring that creditors receive a fair allocation of the insolvent debtor's assets consistent with established priorities and preserving the integrity of the insolvency estate. Avoidance provisions may also have a deterrent effect, discouraging creditors from pursuing individual remedies in the period leading up to insolvency if they know that these may be reversed or their effects nullified on commencement. Transactions are typically made avoidable in insolvency to prevent fraud (e.g. transactions designed to hide assets for the later benefit of the debtor or to benefit the officers, owners or directors of the debtor); to uphold the general enforcement of creditors' rights; to ensure equitable treatment of all creditors by preventing favouritism where the debtor wishes to advantage certain creditors at the expense of the rest...¹¹⁷⁷

¹¹⁷¹ UNCITRAL (2005) at 272.

¹¹⁷² UNCITRAL (2005) at 272.

¹¹⁷³ UNCITRAL (2005) at 120 & 131.

¹¹⁷⁴ UNCITRAL (2005) at 135.

¹¹⁷⁵ UNCITRAL (2005) at 135.

¹¹⁷⁶ UNCITRAL (2005) at 135.

¹¹⁷⁷ UNCITRAL (2005) at 136. It is a generally accepted view that our provisions do not vest a practitioner with specific powers to avoid certain transactions preceding commencement of rescue and it has been argued that this is a critical short-coming of the new regime.

In line with the benefits of a procedure that allows for the avoidance of certain transactions, the guide recommends that States must endeavour to achieve a balance between competing social benefits, in the form of an ability to maximise the value of an insolvent estate for collective creditor benefit, with the possible effect of such powers potentially undermining contractual predictability and commercial certainty.¹¹⁷⁸ It is for this reason that a regime must establish a set of objectively clear criteria for application of avoidance powers.¹¹⁷⁹

The guide provides scope for the amendment of the plan after approval by creditors.¹¹⁸⁰ Such an approach incorporates flexibility, where an adopted plan is incapable of being implemented in its original form.¹¹⁸¹ To facilitate expediency, proposed plans may be voted upon by creditors (or parties) whose rights are affected by the amendment rather than requiring a vote by the general body.¹¹⁸² Alternatively, creditors who supported the original plan may be given an opportunity to accept or reject proposed amendments within a specified period once notice has been given.¹¹⁸³ The requisite degree of creditor participation will ultimately depend on the degree of proposed amendments.¹¹⁸⁴

In relation to successful plan implementation (and the failure of same), the following is observed:

[Where the debtor defaults in performing in terms of the plan] Some insolvency laws provide that the court can terminate the plan and convert the proceedings to liquidation. Other laws provide that the plan will only be terminated in respect of the obligation breached (it otherwise remains valid). The creditor whose obligation is breached will not be bound by and will have its claim restored (in the event that it agreed to receive a lesser amount under the plan) to the full amount. In some cases, this will occur where the debtor has fallen significantly into arrears in the performance of its obligations under the plan...¹¹⁸⁵

An alternative may be to deem proceedings to have come to an end, where creditors are permitted to freely pursue their claims against the debtor.¹¹⁸⁶ However, certain challenges may arise depending on the extent of the plan's implementation

¹¹⁷⁸ UNCITRAL (2005) at 137.

¹¹⁷⁹ UNCITRAL (2005) at 137. This may include incorporating objective, subjective criteria or a combination of both.

¹¹⁸⁰ Although applying different tests, it has been observed that both U.K. and U.S. provisions provide scope for amendment of an approved plan in certain instances.

¹¹⁸¹ UNCITRAL (2005) at 230.

¹¹⁸² UNCITRAL (2005) at 230.

¹¹⁸³ UNCITRAL (2005) at 230.

¹¹⁸⁴ UNCITRAL (2005) at 230.

¹¹⁸⁵ UNCITRAL (2005) at 231. It is important to observe that in discussing implementation of the plan, specific reference is made to 'full implementation' and the devising of mechanisms to ensure that this in fact occurs (either through court supervision or appointment of an independent person).

¹¹⁸⁶ UNCITRAL (2005) at 231.

prior to the occurrence of breach.¹¹⁸⁷ Having briefly discussed the UNCITRAL model on insolvency law, a summary comparison of approaches in U.K., U.S. and South Africa follows.

5.5 COMPARISON OF THE UNITED KINGDOM, UNITED STATES AND SOUTH AFRICAN APPROACHES

The U.S. Bankruptcy Code's chapter 11 is described as pro-debtor in its orientation in comparison to the U.K. administration procedure. Commentators have argued that the U.K. rescue regime- through the enactment of the Insolvency Act of 1986 and its amendment by the Enterprise Act 2002- has moved in the U.S. direction, placing emphasis on reorganisations rather than on the sale of company assets, which have in the past dominated English rescue discourse.

Chapter 11 and the administration procedure cater for the preservation of the business as a going concern as a primary objective while permitting the achievement of alternative objectives.¹¹⁸⁸ A distinguishing feature with administration is that it is a gateway procedure to other mechanisms such as schemes of arrangements, company voluntary arrangements and pre-packs as opposed to the singular procedure as seen in the Bankruptcy Code or Companies Act of 2008.

In terms of section 3(1)(c), the Insolvency Act mandates the realisation of property in order to make a distribution to secured or preferred creditors. This is in further contrast to the South African provisions, which make reference to the broader category of creditors and shareholders, without specific reference to the nature of security interest held. This is particularly relevant in light of the fact that our procedure allows for the weakening of real security interests without incorporating protective doctrines for real security holders in the form of 'adequate protection' as seen in the U.S. discourse.

Administration requires that a debtor demonstrate a degree of insolvency as well as the potential benefits to be derived from recourse to proceedings in light of the

¹¹⁸⁷ UNCITRAL (2005) at 231.

¹¹⁸⁸ Interestingly, both provide for (i) the revival of the company and its finances or (ii) sale of its business to a third party or (iii) the liquidation of the company's assets for the benefit of secured or preferential creditors. Within the South African context, only two are clearly provided for; (a) the revival of the company from a financial perspective or (b) the introduction of an intervention that will ensure a higher dividend for creditors than in liquidation. In relation to the latter objective, it is not clear as to which creditors are being referred to.

regime's objectives.¹¹⁸⁹ This is not required by chapter 11. The Code contains a requirement of good faith in that the filing must not be for the purpose of frustrating creditors or for an improper purpose.

Chapter 6 makes use of a test which is arguably more precise than that of its comparative counterparts. However, the current provisions have contributed to 'bad faith' filings where a debtor is either not financially distressed or does not possess reasonable prospects of success

Administration effects a complete displacement of existing management upon sanction of appointment by the court and acceptance of the nomination by the administrator. The U.K. Insolvency Regulations provide a clear framework for an administrator's qualifications as well as the criteria for appointment. This does not exist within the chapter 11 framework as the default position is that the existing management remains in control. The South African approach may be described as more of a co-operative/compromise model with ultimate control vesting in the appointed business rescue practitioner. In light of this factor, it is foreseeable that existing management will be reluctant to initiate proceedings where the signs of financial distress begin to appear.

This may in a similar vein provide an explanation as to why both the South African regime and its U.K. counterpart contain wrongful/ reckless trading provisions which penalise directors for late filing. Apart from requiring that the proposed practitioner be a member in good standing with an accredited profession as well as not be disqualified to act as a director, the Act does not provide a concrete set of criteria regulating the qualifications, competencies and further requirements which should be satisfied prior to assuming appointment.

An essential feature for success of proceedings is the application of a moratorium against claims. Its effect is to suspend legal and enforcement proceedings against the debtor company's property. While this finds application in both U.K. and U.S., there are slight differences in relation to the degree of its application and exceptions to it. A clear example is that while chapter 11 does not bar criminal proceedings against the debtor during bankruptcy, these proceedings are barred by the moratorium during administration except where courts in the latter jurisdiction order the contrary. The U.S. approach contains listed exceptions to the moratorium's

¹¹⁸⁹ In certain instances it is sufficient that it be shown that a debt is due or deemed due.

application, providing creditors with greater certainty regarding instances when it may be lifted. For the latter to occur, application must be made to court. Within the U.K. context, in the absence of a court application, the administrator may consent to enforcement or legal process being commenced.

The moratorium provision in our Act contain elements seen in both jurisdictions; vesting discretionary powers on both the courts and the rescue practitioner, while also providing a closed list of exceptions to the moratorium's application. A feature unique to our moratorium provisions reinforcing the concern raised regarding Chapter 6's balancing of creditor interests is that despite the extension of the moratorium to include contractual arbitration proceedings by our courts, it is not clear whether this will include employee arbitrations if regard is had to relevant provisions of the Labour and Companies Acts. On the current wording of the relevant section, it is my view that employee arbitration proceedings may continue notwithstanding the application of the moratorium.

The U.K. has historically sought to place the interests of a debtor company's creditors at the forefront, resulting in a highly concentrated institutional creditor market with marked dominance of banks. A view has been advanced that this been diluted in favour of the broader benefit of unsecured creditors, post enactment of the Enterprise Act 2002. By contrast, an observation has been made that U.S. bankruptcy, traditionally viewed as pro-debtor, has seen the ascendance of creditor power during proceedings through contractual leveraging mechanisms which have included the creative use of post-petition loans. It is expected that this trend will grow within the South African context as well.

Both the U.K. and the U.S. make provision for the prioritisation of certain qualifying pre-commencement costs and expenses, whether secured or not. Administration permits a narrow range of pre-commencement costs and expenses to fall into the category of expenses of the administration. Chapter 11 caters for this aspect through critical vendor motions/necessity of payments doctrine.

In respect of both the U.K. and U.S. jurisdictions, pre-commencement wage claims are delimited in terms of the time period within which employee creditors are entitled to preference. These are in addition capped in terms of the monetary value which may be claimed as preferent. Outstanding amounts which exceed the 'claimable time period' or maximum amount are treated as ordinary concurrent claims. This approach ensures that there is a limit on financial value being extracted

from the company. It is submitted that neither of the comparative jurisdictions discussed go as far as the South African approach in terms of the degree of pre-commencement wage claim preference. In this way pre-commencement wage entitlements may well be paid in full in terms of the proposed plan (leaving little or nothing left for concurrent creditors), while post-commencement wages are payable in priority to secured creditors as well as lenders who have advanced funds on a post-commencement funding basis.¹¹⁹⁰

Related to the above point and from a statutory interpretation perspective, the following is observed: Under the South African system, while post-commencement finance includes remuneration claims as well as funds advanced by a lender (termed ‘financing’), the provision does not specifically include the monetary value of actual goods or services supplied by a supplier-creditor after proceedings.¹¹⁹¹ On an ordinary grammatical interpretation, the possible effect of this is that a goods/services supplier creditor could well find that its post-commencement claim for goods services/supplied in fact ranks below a credit facility or money advancing lender, advancing finance instead of trading goods/services to the debtor. In short, the post-commencement finance provision of the Companies Act potentially excludes suppliers of goods/services which are not money or credit facilities from its ambit. Such discrimination is patently unfair as there is no particular reason to distinguish between these two creditors.¹¹⁹²

In relation to the voting on a proposal by an administrator or the debtor-in-possession, both the U.K. and U.S. jurisdictions allow creditors to vote only to the extent to which their claims against the debtor are not paid in full (i.e. impaired). Therefore, the value of voting rights is determined by the level of impairment. This approach reflects a greater level of fairness in relation to creditors *inter partes* as a creditor participates in proceedings only to the extent that it is affected financially by the rescue intervention.

¹¹⁹⁰ Where there is insufficient financial value within the debtor to ensure the full payment of employees’ pre-commencement preferential claim or where the plan proposes to compromise this in the interests of broader concurrent creditors, employees may simply opt to vote against the plan.

¹¹⁹¹ Companies Act 2008, Section 135.

¹¹⁹² It will be interesting to see how the term ‘...the costs of business rescue proceedings...’ is interpreted by courts in future. See *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd & others* 2011 4 SA 600 (WCC) (11 August 2011) *supra* at paras 4-5 where the court articulated the nature of costs incurred by an applicant in bringing business rescue proceedings. A possible solution may be to define ‘post-commencement finance’, currently undefined, to include the monetary value of goods or services advanced by suppliers, after commencement, whether or not they are financial institutions.

The U.S. Bankruptcy Code allows for the creation of super preferences during chapter 11 proceedings as well as the ‘priming’ of pre-existing liabilities in certain instances and these preferences subsist should the debtor be liquidated. It has been argued that from an analysis of the U.K Insolvency Act provisions, administration provides a limited scope for super-priority preference. Where the debtor is ultimately liquidated, the rules of insolvency come into play in substitution to any preferences which may have prevailed in administration. Super-preferent ranking of claims in terms of the South African Companies Act resembles the American approach without similar controls for pre-existing creditors.

Both the U.S. and U.K. regimes allow for the rejection of contracts by the administrator or debtor-in-possession. This power seems to have found extension within the U.S. context, where executory contracts have been found to include bargaining agreements. The Bankruptcy Code, through a structured process, allows for the amendment or rejection of existing employee bargaining agreements. This flexibility assists in facilitating the financial recovery of a debtor and is further reflective of a practical approach to the exigencies of commerce. The latter power is significant in light of the limitations imposed on cancellation and rejection of employee contracts specifically in the South African procedure. Chapter 6 permits this but through strictly defined parameters. It has further become accepted that even though business rescue practitioners may suspend or cancel contracts, this does not extend to the avoidance of various transactions. This is viewed as a significant limitation of the new regime when compared to its predecessor, judicial management.

Chapter 11 provides for the cram-down of dissenting classes of creditors. This entails forcing of a vote in favour of the plan notwithstanding lack of support from a specific class of creditors. It is observed that such action may occur only through court sanction, provided that the court is satisfied that the fair and equitable standard has been complied with as well as compliance with the absolute priority rule. In contrast, the U.K. courts are vested with the power to substitute a vote of creditors. Our courts have affirmed that a ‘binding offer’ only binds the offeror. However, a creditor’s vote against the plan may be declared ‘inappropriate’ and substituted by court.

Having engaged in a discussion of the approaches of comparative jurisdictions, it is observed that both contain important mechanisms capable of enhancing our own rescue regime. While applying different methods in resolving the same problem in certain respects, both have sought to incorporate protections for (i) the debtor *vis-à-vis* its creditors and *vice versa* as well (ii) creditors *inter partes*. In relation to the latter, this has summarily been observed in the manner in which both jurisdictions regulate the extent of participation rights, allocation and reallocation of claim rights as well the degree to which creditors are expected to make concessions for company survival. The manner in which some of these approaches may be incorporated into our own rescue framework is explored and recommendations for reform are made in the last chapter.

CHAPTER 6: CONCLUSION

6.1 INTRODUCTION

The Guidelines for Corporate Law reform effectively set the tone for a significant departure from the previous company law regime.¹ Part of this exercise entailed a paradigm shift in thinking of the purpose of the company as being primarily to further the interests of its shareholders as residual claimants.² The nexus now includes the relationship between the company and creditors, employees, the state, the environment, consumers, suppliers and broader Black Economic Empowerment (BEE) initiatives.³ Without committing to one jurisprudential position (in the form of the traditional shareholder-oriented model, the enlightened or the pluralist approach) the DTi *Guidelines* affirm that equally important are economic factors. Whether this approach is reflective of an enlightened shareholder or pluralist approach is debatable.⁴

The South African regime fares fairly well when viewed in the light of instruments such as the UNCITRAL *Legislative Guide on Insolvency law*, this being an authoritative source on insolvency and corporate rescue law within the international domain.⁵ It would seem that having incorporated some of the approaches recommended in the *Guide*, South Africa has sought to take into account its unique economic and socio-economic circumstances. While the approach in Chapter 6 of the 2008 Act complies with many recommendations made in the *Legislative Guide* in many respects, it deviates in certain respects. The differences between ours, comparative approaches in the United Kingdom and United States, in light of the *Legislative Guide*, have been explored in the previous chapter.

¹ In a brief but insightful analysis of the DTi's *Guidelines for Corporate Law Reform*, Pippa Faul *The Impact and origins of employee rights in chapter 6 of the Companies Act 71 of 2008* (LLM Thesis, UKZN, 2015) available online at https://researchspace.ukzn.ac.za/bitstream/handle/10413/12376/Faul_Phillippa_Mary_2015.pdf?sequence=1&isAllowed=y (accessed on 1 October 2016) at 24 argues that the current South African company law model has modified the enlightened shareholder model with the inclusion of pluralist elements in certain instances.

² Department of Trade and Industry (2004) at 26.

³ Department of Trade and Industry (2004) at 10.

⁴ From a gloss of the policy framework outlined at 25 of the DTi's *Guidelines supra*, it would seem that the enlightened shareholder approach may have, at least at this stage, been a guiding principle. It is at this juncture worth emphasising that central to the thesis, is the view that the manner in which stakeholder interests have been balanced, has for practical purposes subordinated the desire to achieve company financial recovery (as a primary goal) to prioritising socio-economic imperatives which lean towards a pluralist approach, with a weighting in favour of certain stakeholders. The *Guide* in certain parts seems to openly endorse the pluralist approach, albeit in limited form; see pp 25-6.

⁵ Levenstein (2016) posits that Chapter 6 broadly complies with UNCITRAL recommendations and standards.

The introductory chapter put forward the view that the current business rescue provisions balance stakeholder interests in a manner that potentially negatively affects the objective of returning the company to a position of solvency as a primary objective. The reasons have summarily been attributed to (i) the definition of business rescue aggregating creditor welfare. In this way treating the general body of creditors as if they fall into the same class or grouping, as well as (ii) the regime's narrow scope of practitioner's fiduciary duties. Fiduciary duties are limited to the company rather than including the company's creditors once rescue proceedings have commenced and (iii) employees, as a category of stakeholder, being granted significant protections in comparison to other unsecured creditors and, in certain instances, in preference to secured interests.

Acknowledging the expansive nature of the injunction in section 7(k) which requires providing for the efficient rescue of financially-ailing companies in a manner that strikes a balance between competing stakeholders interests, the thesis has sought to narrow its analysis to a critique of the manner in which the Act balances the diverse interests of the company's creditors when it enters business rescue proceedings.

Making the balance even more difficult to achieve from a legislative perspective is the often 'high conflict' environment of company insolvency, where creditors are in large part prevented from mitigating their losses by initiating enforcement proceedings against the debtor.⁶ In this regard, legislation often has to balance the need to (i) create a conducive environment which accommodates economic growth and encourages entrepreneurship, (ii) provide an opportunity for financial recovery for a company which has succumbed to financial hardship due to unforeseen economic circumstances (or internal factors) whilst still possessing good prospects of financial recovery, and (iii) take cognisance of these factors while providing a degree of protection for pre-insolvency contractual promises but in a manner that does not result in the ultimate demise of the debtor.

The differences in judicial approach by our courts in some of the case law evidences the difficulty and complexity of the injunction imposed by section 7 in light of section 128 of the Act. Courts are often required to adjudicate on a business rescue

⁶ A critique or analysis into the manner in which creditor interests are balanced and (or) protected is no easy task. Citing Porter *et al*, with cautious approval, Brouwer (2006) at 9 captures the difficulties often faced when such task is undertaken:

'La Porta *et al* concede that measuring the strength of creditors' rights is more complicated than measuring shareholders' rights as the rights of some creditors must prevail at the expense of others...'

with limited information, where time is ‘of the essence’ for company survival. To dismiss interpretive challenges often faced by our courts simply as being a result of poor legislative drafting is to fail to comprehend the often nuanced variables and interests at play during business rescue.⁷

The thesis has posed the question whether is it the role of the corporation or government to fulfil socio-economic imperatives. An answer to this question is far from clear and not without controversy. However, it has been observed that the socio-economic impact of corporations on surrounding communities justifies regulation. While the theory of the corporation informs us of different attributes with which we may wish to vest our own conception of company law, it does not inform us which theory or corporate model will work better within a South African society. In the light thereof, it has been argued that in seeking to balance interests within the context of company insolvency, the question of which stakeholder⁸ is most deserving of protection is one which must be considered.

The view has been advanced that concessionary and stakeholder theories best account for the multifaceted nature of interests in the corporation and provide a framework for understanding the ethos underpinning the Companies Act of 2008. I have argued that shareholder theory fails to adequately account for the multi-faceted nature of interests mandated by the 2008 Act’s purpose provision and thus is unable to provide for a reconciliation of such interests. Conversely, I have put forward the view that stakeholder and concessionary theories are able to better illuminate the position adopted in the Act’s purpose and business rescue provisions.

In the introductory chapter it was observed that the new regime was precipitated by a number of company liquidations.⁹ This was viewed as a scathing affirmation of judicial management’s inefficiency as a company rescue mechanism. In order to track the pace of improvement since the enactment of our new company regime, a brief analysis of recent liquidation figures and business rescue statistics is relevant.

⁷ Further, the infusion of our company law with both Constitutional as well as socio economic imperatives has made the task that much more challenging.

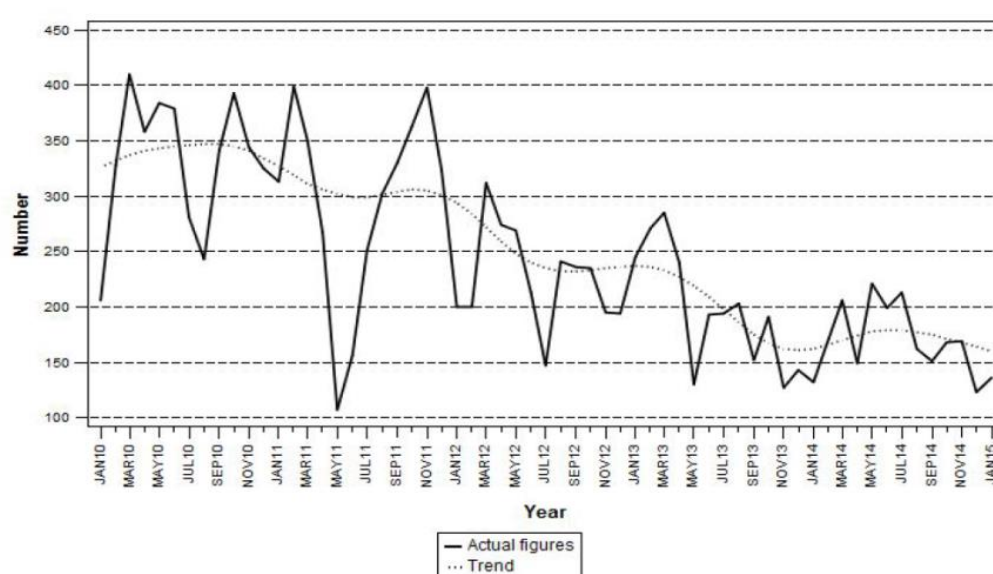
⁸ The term ‘stakeholder’ has been observed to include the company’s suppliers, customers, employees, investors, the community, ethical pressure groups *et cetera*. It is non-exhaustive. See Chapter 1.

⁹ See discussion in Chapter 1.

6.2 RECENT LIQUIDATION STATISTICS

Statistics released by Statistics South Africa for January 2015 indicate that liquidation figures overall increased by 6.5% (from 402 to 428) in the three months ending in January 2015 compared to the figures for January 2014.¹⁰ The percentage increase was largely due to a 7.7% rise in voluntary liquidations (with a recorded increase of one case in respect of compulsory liquidations).¹¹ Positively, preliminary statistics released during this quarter reflected a downward trend in liquidations between January 2010 to January 2015 as depicted by the below diagram¹²:

Figure 1 – Number of liquidations



Figures for September 2016 reflected a 15.4% increase in liquidations overall when compared to September 2015 figures.¹³ The statistics, however, observed a decrease in liquidations in respect of businesses in community, social and personal service industries.¹⁴ A downward trend was further observed in relation to compulsory liquidations overall in the period January 2010 to December 2015.¹⁵

The above figures may have been influenced by a variety of economically intervening factors whether in the form of financial collapse (or ripple effects thereof felt at a much later stage), a downturn in commodity prices or the effect of a

¹⁰ Statistics South Africa *Statistics of Liquidations and Insolvencies (preliminary) January 2015* (expected release date March 2015) at 2.

¹¹ Statistics South Africa (2015) at 2.

¹² Statistics South Africa (2015) at 2.

¹³ Statistics South Africa *Statistics of Liquidations and Insolvencies (preliminary) September 2016* (expected release date 28 November 2016) at 2.

¹⁴ Statistics South Africa (2016) at 2.

¹⁵ Statistics South Africa (2016) at 5.

breakdown in labour relations and continuous strike action.¹⁶ A closer analysis of possible reasons behind the 2016 figures would require a comprehensive analysis and critique, unfortunately beyond the scope of this thesis. The statistics, however, provide a basis upon which business rescue statistics are to be analysed.

The Companies and Intellectual Property Commission (CIPC) has published status reports on business rescue proceedings.¹⁷ From recent figures¹⁸, the following can be observed: From the year 2011 (when the business rescue procedure came into force) to period ending March 2016, the total number of business rescue proceedings formally commenced stands at 2148.¹⁹ This is in comparison to the total number of cases terminated at 1019, which is roughly 47% of the total number of cases commenced. From the latter figure, 197 of the cases terminated were followed by liquidation, while 319 cases were terminated through the filing of the CoR 125.2 Form²⁰. There were 310 cases terminated through the filing of a CoR 125.3 Form²¹.

A further but brief explanation of the figures is important. I have advanced the view²² that a CoR 125.2 Form will be filed where an appointed practitioner concludes that there are no reasonable grounds to believe that the company is in financial distress (even if directors made averments alleging this while initiating the section 129 resolution procedure or where an affected person commenced proceedings through the court application in terms of section 131). The CoR 125.3 'Substantial Implementation' notice is filed where an adopted business rescue plan has been implemented in accordance with its terms and conditions.²³

A substantial implementation filing infers that business rescue proceedings have been successful, at least in the practitioner's subjective view.²⁴ This does not necessarily mean that a termination on this basis is as a result of the company having returned to a position of solvency. To amplify the point, the figure of 310 may include

¹⁶ It is to be emphasised that this is not a closed list.

¹⁷ Department of Trade and Industry *Status of Business Rescue Proceedings in South Africa* (March 2016) available at http://www.cipc.co.za/files/9614/6857/6141/Status_of_Business_Rescue_Proceedings_in_South_Africa_March_2016.pdf [accessed on 31 October 2016].

¹⁸ Year ending March 2016.

¹⁹ Department of Trade and Industry (2016) at para 2.

²⁰ Filed where the practitioner concludes that there are no longer reasonable grounds to believe that the company is financially distressed.

²¹ Also known as a Notice of Substantial Implementation.

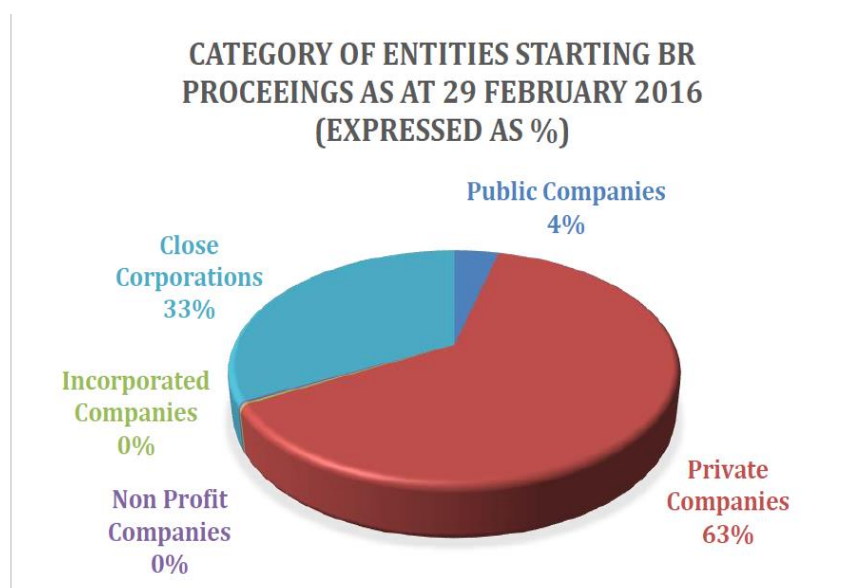
²² See discussion in Chapter 4.

²³ See section 152(6) read with 154(1) & (2) of the Companies Act of 2008.

²⁴ Section 132(2)(c)(ii). It is acknowledged that there are differing and conflicting views on the correct interpretation of this aspect.

entities where a wind down and piece-meal sale of assets (including a termination of employment contracts) was contemplated as part of the process of business rescue.²⁵

Commencement data from CIPC indicates that overall, the largest number of business rescues which were commenced consisted of private companies at a figure of 1354, followed by Close Corporations at 701 and Publicly traded companies at 83.²⁶ The figures are expressed in percentages below²⁷:



From a statistical perspective, business rescue, at least at this stage, finds most application in small to medium sized entities.²⁸ While the reasons therefor have not been comprehensively documented in the South African literature, a few inferences may be drawn. Popularity among small to medium sized businesses (i.e. private entities and close corporations) may be attributed to the perceived ability of the new regime to effect a restructure of a financially ailing company's affairs. There are currently a number of challenges in terms of objectively determining the 'bottom-line' value of the new regime; specifically in terms of the extent to which companies are rescued in the primary sense (i.e. returned to a position of solvency).

²⁵ How this is in fact a 'rescue' remains unclear. This, it is submitted, is a possible reason why it has been challenging to quantify the bottom-line benefit of the new procedure on our economy as the wind-down and sale of company assets in a piecemeal fashion significantly resembles liquidation, albeit without similar protections for stakeholders.

²⁶ Department of Trade and Industry (2016) at para 3.

²⁷ Source: Department of Trade and Industry (2016) at para 3.

²⁸ From figures provided by CIPC, a downward trend in public company filings is observable. While the total number of filings during 2011-12 years stood at 53, this number has significantly decreased to five between the years 2015-16.

It may further be the case that while the new business rescue regime permits easy access, its ability to facilitate a wind-down with the benefit of i) the company being able to retain a measure of goodwill, which may presumably be sold at a higher value during business rescue than in liquidation and ii) vaguely defined powers of recoupment on the part of the practitioner relative to those of a liquidator or the previous judicial manager, may make the procedure more attractive for wayward directors than liquidation.

The statistics may further indicate the extent to which small to medium sized companies are vulnerable to negative economic circumstances, as well as an inability to negotiate with creditors without a protective mechanism in the form of a moratorium against the enforcement of claims. Conversely, the reduction in filings by public companies from 2011 to date may indicate the relative unattractiveness of the regime for public companies when regard is had to i) the effect that a publicised business rescue filing may have on a publicly-traded company's share price especially in light of ii) greater negotiating power that public companies have (often due to a larger asset pool) in relation to their creditors and thus their ability to restructure outside of the rescue process.

The statistics are further significant because small to medium sized companies often have a broad pool of small to medium sized creditors who, due to their size, are often limited in terms of their ability to exercise creditor activism to same extent observed in relation to institutional creditors.²⁹ This aspect renders the need to effectively and fairly balance competing stakeholder interests, when the process is commenced, more pertinent.

6.3 PROPOSED REFORMS

A number of shortcomings have been identified in respect of the new regime in previous chapters.³⁰ This part recapitulates on these and explores the possibility of introducing reforms in relation to the following: (i) the aggregation of creditor

²⁹ This may be due to a creditor's inability to access the most perfect information at the most perfect time (or an inability to maximise the value of information received even where the timing is opportune) or due to a lack of financial resources which enable creditor activism.

³⁰ It is appreciated that there is a growing literature on proposed reforms in this area. The thesis has made recommendations throughout the business rescue chapter. The purpose of this chapter is to discuss specific recommendations which, it is hoped, will enhance our regime's ability to better balance conflicting interests in an efficiency enhancing manner. Loubser (2010) has charted significant ground in her LLD thesis recommending reforms to the Companies Act. This work does not intend to repeat or critique the learned commentator's recommendations.

welfare, (ii) weak administrative controls to accessing the procedure, (iii) bankruptcy courts as a mechanism for interest balancing, (iv) the scope of fiduciary duties imposed on the practitioner, (v) powers in relation to avoiding certain transactions, (vi) the protection of property interests, (vii) the treatment of pre and post-commencement creditors, (viii) the rights accorded to employees in relation to other categories of creditors, (ix) voting on the proposed plan, (x) the termination of proceedings as well as the (xi) interplay between adoption of the proposed plan and (xii) discharge from debt. I now turn to discuss possible measures that may be taken in resolving each.

6.3.1 AGGREGATION OF CREDITOR WELFARE

It is appropriate to begin with the definition of ‘business rescue’ in section 128. It has been observed that the U.K. legislation provides specifically for three purposes, which envisage rescuing the company as a going concern or achieving a better result for creditors of the company as a whole than would be likely if the company were wound up (without first being in administration) or realising property in order to make a distribution to one or more secured or preferential creditors.

While the U.K. provides for a grading of objectives, it grants sufficient discretion to an appointed administrator to determine which course to take. Equally important, where an administration envisages the second purpose, the procedure must ensure that creditors as a whole receive a result better than they would have received than in liquidation (and not simply a benefit to certain classes to the exclusion of others). Where a distribution is envisaged, it must be to the benefit of secured or preferential creditors. In this way the U.K. approach is clear as to which category of creditor should be the beneficiary of a proposed course of action.

I have argued that the South African approach aggregates creditor³¹ welfare in its definition, without specifically stipulating that, where the alternative purpose is envisaged, for which category of creditor proceedings are meant derive a ‘better return’.³² The current wording makes it possible for directors to initiate proceedings

³¹ This may be illustrated as follows: A plan may propose that a (minority) creditor who is preferent in liquidation (e.g. The South African Revenue Service) receives nothing in terms of the rescue plan while a certain number of concurrent creditors receive a dividend in terms of the plan, even if the former would in this instance have been entitled to a dividend in liquidation. What happens in such instance? Can it not then be argued that the rescue initiative falls foul of the provisions of section 128 because this category of creditor would clearly have received a better return?

³² Companies Act of 2008, section 128(1)(b)(iii).

only to have a piecemeal sale of company assets without similar protective mechanisms for creditors found in liquidation.³³

It is unclear why a better return for shareholders is an alternative to a better return for creditors as a group. Reference to ‘shareholders’ should be removed. The definition ought to cater either for the return of the company to a position of solvency³⁴ or for the sale of a whole or part of its business to a third party in order to derive a better return for the company’s concurrent, preferred and secured creditors than in liquidation.³⁵ The piecemeal sale of the company’s assets (and thus a ‘wind-down’) in order to derive a better return to preferred and secured creditors ought to be the domain of insolvency law and the company should in such instance be liquidated.³⁶

Even more unclear is the confusing reference to the term ‘likelihood’ while both sections 129 and 131 make use of ‘reasonable prospect’ as the appropriate test. It has been observed that while the origins of ‘likelihood’ as a test may be traced back to section 457 of the Companies Act of 1973, the transplantation of this term into section 128 of the new Act may result in unnecessary confusion. I recommend that the section be amended to read as follows³⁷:

‘business rescue’ means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—

- (i) the temporary supervision of the company, and of the management of its affairs, business and property;
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in

³³ The proposed business rescue plan may envisage a sale of business or assets or both as opposed to returning the company to a position of solvency.

³⁴ Financial revival through a restructure of its affairs, debt, business, property or equity.

³⁵ Loubser (2010) makes a similar argument in her thesis at 332-333. She further argues for a secondary purpose of rescuing the business or a major part of it. It is my view that this is a better approach than the current wording and resonates with the observations made by Levenstein (2016) where, at 73, he observes as follows:

‘... Business rescue, as its name suggests, recognises the value of the business entity as a going concern, rather than the entity itself. This is in line with the modern trend of international corporate rescue regimes, which places primary emphasis on saving the enterprise and the real business carried on by the juristic person, in whole or in part, rather than on the survival of the juristic person itself...’

³⁶ It is acknowledged that in liquidation, the business of the company may be sold to a third party. However, the sale of business may be construed as falling within ‘rescue’ as a concept and properly be catered for within the procedure without the degree of stigma ordinarily attaching to liquidation as the latter may be value diminishing (i.e. a negative effect on business’ goodwill). Where a ‘wind-down’ of the company is envisaged, it is submitted that Insolvency Law contains better protective mechanisms for creditors.

³⁷ Wording that should be removed has been struck through and the recommended wording underlined.

a manner that ~~maximises the likelihood~~ ensures a reasonable prospect of the company continuing in existence on a solvent basis or a sale of its business to a third party, including the transfer of its obligations where applicable, resulting in a better return for the company's secured, preferent and concurrent creditors than would result from the immediate liquidation of the company. ~~if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company;~~

6.3.2 WEAK ADMINISTRATIVE CONTROLS

In conjunction with recommended amendments to the definition of 'business rescue' it is proposed that administrative requirements for accessing the procedure be strengthened to require more than simply a board resolution and an affidavit for financial distress to be established. This could be in the form of inserting a provision which requires a company to submit audited financial statements to the Commission.³⁸ The filing requirements finding application in chapter 11, which include a list of creditors as well as company assets and liabilities, may be a helpful starting point. It has been observed that the requirements for commencing proceedings by resolution are unduly lax in comparison to those applicable in a commencement through court procedure.³⁹

A further advantage of producing concrete financial information of the company is that it may help resolve information asymmetries between the company's various stakeholders and enable those affected to take steps to protect their interests earlier in the process.⁴⁰ It is recommended that the resolution procedure in section 129 be amended to read as follows:

³⁸ In line with the Companies Act and depending on the size of the company. This course of action could both force the company to comply with the Act in relation to accounting records and financial statements, provide a greater degree of transparency for creditors earlier in the process and possibly minimise time spent by a rescue practitioner, thus reducing the cost of the intervention. Levenstein (2016) argues for the use of pre-assessments by a prospective practitioner in order to determine the prospects of success of a proposed business rescue before the procedure is commenced.

³⁹ A related challenge is that of repeated filings permitted by section 129, especially within the context of prevailing weak administrative controls. It recommended that an embargo be imposed where within the immediately preceding twelve months, directors of the company initiated business rescue proceedings through board resolution or a compromise procedure in terms of section 155. In such instance affected persons should only be entitled to commence proceedings through the section 131 court procedure. The court would be in a much better position to consider the facts and any objection that creditors may have. This approach would resemble the restrictions seen in para 23 of the Insolvency Act of 1986, albeit departing from its stricter counterpart in favour of flexibility.

⁴⁰ Creditors would have access to more or less the same information much earlier in the process. See discussion regarding informational rights of certain stakeholders to the exclusion of others in Chapter 4.

129 Company resolution to begin business rescue proceedings

-
- (3) Subject to subsection (4) Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must—
- (a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and
 - (b) appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.
- (4) A resolution contemplated in subsections (1) & (3) must—
- (a) be accompanied by a sworn statement of facts in the form of an affidavit; and
 - (b) include financial statements as contemplated in sections 28- 30 of the Act, where applicable and regulations 25, 27, 28 & 29 of the Companies Regulations 2011, where applicable
- (4) (5) After appointing a practitioner as required by subsection (3) (b), a company must—
- (a) file a notice of the appointment of a practitioner within two business days after making the appointment; and
 - (b) publish a copy of the notice of appointment to each affected person within five business days after the notice was filed.
- (5) (6) If a company fails to comply with any provision of subsection (3) or (4)—
- (a) its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity; and The purported filing is legally invalid and of no force or effect; and
 - (b) The Commission shall be entitled to reject the filing on the basis of non-compliance with subsection (4)
- (b) the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a court, on good cause shown on an ex parte application, approves the company filing a further resolution.
- (6) (7) A company that has adopted a resolution contemplated in this section may not adopt a resolution to begin liquidation proceedings, unless the ~~resolution has lapsed in terms of subsection (5), or until the~~ business rescue proceedings have ended as determined in accordance with section 132 (2).
- (7) (8) If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128 (1) (f) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section.

6.3.3 BANKRUPTCY COURTS AS A MECHANISM FOR INTEREST BALANCING

A question that ought to be considered is whether bankruptcy (or business rescue) courts would serve to enhance the effectiveness of our rescue regime in light of (i) the distinction between chapter 11 and our Chapter 6 proceedings, (ii) the administrative and drafting weakness observed in our legislation and (iii) the perceived financially prohibitory nature of court- oriented proceedings.⁴¹

There is currently an existing framework within the 2008 Act for the allocation of judges within the various district courts for the purpose of specifically

⁴¹ A contrary argument can be made to the effect that a regime with a strong court orientation may in fact be better suited to providing a voice to smaller supplier-creditors who may not have the necessary funds to initiate and sustain a legal challenge on an issue they consider critical during commencement of proceedings. A court oriented procedure may in fact enable them to ‘piggy back’ while incurring significantly less cost.

adjudicating on business rescue matters.⁴² Factors that may be relevant to responding to the above are (i) capacity and cost constraints - availability of courts and re-allocation of resources within our court system, (ii) the possible risk of judges making, rather than following the letter of the law in line with what the respective judge considers to be equitable⁴³ - specifically a risk where the law is vague and (iii) the risk of judges vesting more rights to parties than those statutorily injunctioned. In addition, the infancy of our own system as well as the size of the South African economy and market for debt trading, when compared to that of the United States, may militate against such route.

Courts have been found to be helpful in resolving many of the practical challenges facing companies in distress within the U.S. context and have further been instrumental arbiters for what is in the interests of not only the debtor company but of its creditors as well.⁴⁴

In the light of the fact that many business rescue filings to date have largely been in relation to small and medium sized companies, the question of a court-oriented bankruptcy system becomes even more pertinent. The Commission to Study the Reform of Chapter 11 observed that while larger corporations dominated the media, a significant number of Chapter 11 filings consisted of small to medium sized corporations.⁴⁵ Concern was expressed regarding the perceived inefficiency of the bankruptcy process for these enterprises, particularly in relation costs and delays associated with the process.⁴⁶ The bankruptcy process was viewed by some as simply to sell the debtor's assets as a going concern in terms of a section 363 sale or to liquidate the company for the sole benefit of the secured lender.⁴⁷

⁴² Companies Act of 2008, section 128(3).

⁴³ Possibly as a result of being 'too invested' in the matter, having dealt with the case from its inception.

⁴⁴ In his thesis at 293, Levenstein (2016) observes factors at play when court involvement is contemplated in a rescue mechanism:

'The role of the courts internationally and the extent of their involvement in reorganisation and/or rescue matters is important and is a key rescue theme. Court process is often time consuming, costly and protracted. This serves to delay matters which can result in the loss in value of the business which is the target of the rescue. In addition, courts play a fundamental role in the jurisprudential development of the rescue process, even more so when the legislation is new and subject to interpretation. Furthermore courts are instrumental in providing the mechanism for the entry of a company into a rescue process...'

⁴⁵ American Bankruptcy Institute (2014) at 1.

⁴⁶ American Bankruptcy Institute (2014) at 276 and references cited therein. The commission observed written submissions which indicated that from the perspective of output, small to medium enterprise revenues were found to surpass the US top 100 companies in terms of capitalisation and were equivalent to approximately 40% of the United States' gross domestic product (GDP).

⁴⁷ American Bankruptcy Institute (2014) at 277 see footnote 986 therein.

The introduction of business rescue courts may occur in two ways. The first could be to adopt a strictly court oriented regime similar to the U.S. A challenge here is that it could make the procedure slower as well as more expensive for affected parties due to fees which may be levied by lawyers in addition to other professionals. Commentators such as Lubben disagree that a court-oriented system is inherently expensive and argue that cost is driven by the complexity of a matter rather than by the process being court driven.⁴⁸

An alternative could be in diluted form, where a business rescue division of the court (through assigned judges) is established for the purpose of adjudicating on particular disputes in a manner similar to that of the Labour Court Division. It is my view that the latter approach is to be preferred and would serve to create expertise within our courts, enhance the procedure, enable expeditious resolution of disputes and close some of the loopholes identified in previous chapters.⁴⁹

6.3.4 SCOPE OF PRACTITIONER FIDUCIARY DUTIES

The business rescue practitioner is an essential component of the success of proceedings. From an analysis of the U.K. and U.S. jurisdictions, there is nothing to infer that an accounting-dominated--- as opposed to lawyer-dominated--- procedure is better suited to enhancing the efficacy and sustainability of rescues.

I have argued that the current articulation of the practitioner's fiduciary duties has created challenges regarding actual or perceived bias on the part of practitioners. A fiduciary duty to the company and a statement to the effect that during rescue a practitioner is an officer of court, does not give a clear injunction to the appointed practitioner to act in the interests of the company in distress as well as in the interests of that company's creditors. Fiduciary duties imposed on the practitioner in section 140(3) should be expanded to include a fiduciary duty to the company's creditors during proceedings.⁵⁰ It is further suggested that the failure to act in the interests of

⁴⁸ Lubben op cit.

⁴⁹ I have highlighted how the court oriented procedure in section 131 may be open to abuse in Chapter 4, specifically in relation to the operation of an interim moratorium against claims. Such a system could include a mechanism for plan feasibility analysis to be conducted by the court in light of the often vague and poorly drafted plans observed in a number of business rescues. A contrary argument is that courts are not business experts and that the question of a plan's feasibility should not be one for the court to decide

⁵⁰ An expanded fiduciary duty framework creates an appropriate platform for mediating competing interests, and enables an analysis into (i) the question of which stakeholder is most deserving of protection (whilst equally cognisant of the company's financial position) and (ii) how best to provide such protection.

the latter be a ground for removal in terms of section 139 rather than a basis for the practitioner's personal liability articulated in section 140(3).⁵¹ I recommend that section 140(3) be amended as follows:

140 General powers and duties of practitioners

- ...
- (3) During a company's business rescue proceedings, the practitioner—
- (a) is an officer of the court, and must report to the court in accordance with any applicable rules of, or orders made by, the court;
 - (b) must perform his/her functions in the interest of creditors as a whole;
 - ~~(b)(c)~~ has the responsibilities, duties and liabilities of a director of the company, as set out in sections 75 to 77; and
 - ~~(e)(d)~~ other than as contemplated in paragraph ~~(b)(c)~~—
 - (i) is not liable for any act or omission in good faith in the course of the exercise of the powers and performance of the functions of practitioner; but
 - (ii) may be held liable in accordance with any relevant law for the consequences of any act or omission amounting to gross negligence in the exercise of the powers and performance of the functions of practitioner.
- (4) If the business rescue process concludes with an order placing the company in liquidation, any person who has acted as practitioner during the business rescue process may not be appointed as liquidator of the company.

6.3.5 POWERS IN RESPECT OF AVOIDING TRANSACTIONS

While the practitioner is vested with certain powers in respect of transactions which fall foul of the provisions of section 141(1)(c), the manner in which these have been articulated in the Act has been lamented by our courts.⁵² It has been observed that these powers are not equivalent to those of a judicial manager in term of the previous judicial management regime.⁵³

Section 141(2)(c) ought to specifically state that in relation to voidable transactions, the business rescue practitioner shall be vested with the same powers of avoidance as an appointed liquidator acting in terms of the relevant provisions of the Insolvency Act.⁵⁴ Such an approach will have the effect of removing any uncertainty caused by the current provisions thus enhancing the regime. It has been observed that both the administration and bankruptcy procedures expressly allow for transaction avoidance within parameters. The reasons why such powers have been largely omitted in the new regime are unclear. I propose that the relevant provisions of section 141(2)(c) be amended as follows:

⁵¹ It is submitted that to expand it further would unduly rupture the schema of the Act, thus fixing one problem only to create another.

⁵² See discussion in Chapter 4.

⁵³ See discussion in Chapter 4.

⁵⁴ The Act's current reference to the practitioner '...tak[ing] any necessary steps to rectify the matter' and the ability to 'direct the management to take appropriate steps' is vague and unhelpful.

141. Investigation of affairs of company

- ...
- (2) If, at any time during business rescue proceedings, the practitioner concludes that—
- ...
- (c) there is evidence, in the dealings of the company before the business rescue proceedings began, of—
- (i) ~~voidable transactions, or~~ A the failure by the company or any director to perform any material obligation relating to the company, the practitioner must take any necessary steps to rectify the matter and may direct the management to take appropriate steps;
 - (ii) Any disposition of its property which if made by an individual could for any reason be set aside in the event of his insolvency, may, if made by a company unable to pay its debts, be set aside by the Court at the suit of the business rescue practitioner in the event of the company being placed under business rescue, and the provisions of the law relating to insolvency shall *mutatis mutandis* apply in respect of any such disposition;
- [Sub-para. (i) substituted by s. 91 of Act No. 3 of 2011.]
- ~~(iii)(ii)~~ reckless trading, fraud or other contravention of any law relating to the company, the practitioner must—
 - ~~(aa)~~ forward the evidence to the appropriate authority for further investigation and possible prosecution; ~~and~~
 - ~~(bb)~~ direct the management to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company.
- (2) A court to which an application has been made in terms of subsection (2) (a) (ii) may make the order applied for, or any other order that the court considers appropriate in the circumstances.

6.3.6 PROTECTION OF PROPERTY INTERESTS

The protection of property interests is important in the schema of Chapter 6.⁵⁵ While the Act delimits the circumstances under which property belonging to the debtor company may be disposed⁵⁶, it grants a business rescue practitioner the power to dispose of any property over which a third party has a security or title interest.⁵⁷ On a closer reading, it would seem that the Act permits a disposal even if it is not pursuant to an adopted business rescue plan and irrespective of whether a holder of the title or security interests consents to it.⁵⁸ It is sufficient if the practitioner ‘promptly’ pays the third party security holder for the interest.⁵⁹ An argument may be mounted to the effect that the provision permits arbitrary deprivation of property.⁶⁰

The section should be amended for consent to be a prerequisite for the disposal.⁶¹ In order to ensure that proceedings are not unduly hampered by a

⁵⁵ More so in light of the regime’s incursion on the ability of creditors to proceed to collect the debt owed to them.

⁵⁶ Companies Act of 2008, section 134(1) & (2).

⁵⁷ Companies Act of 2008, section 134(3).

⁵⁸ Companies Act of 2008, section 134(1) which permits the sale of property in the ordinary course of business or in a *bona fide* transaction for fair value approved in advance and in writing by the practitioner.

⁵⁹ Companies Act of 2008, section 134(3).

⁶⁰ Act 108 of 1996, section 25. Even if implemented through a law of general application in the form of the Companies Act of 2008.

⁶¹ The current wording further applies the inexact term ‘promptly’ which may further compound potential prejudice to a security holder.

belligerent security or interest holder, the latter should not ‘unreasonably’ withhold its consent. I recommend that the relevant section be amended to read as follows:

134 Protection of property interests

- ...
- (3) If, during a company’s business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must—
- (a) obtain the prior consent of that other person, ~~unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person’s security or title interest;~~ and
 - (b) ~~promptly~~ within a period of 10 business days after the disposal—
 - (i) pay to that other person the sale proceeds attributable to that property up to the amount of the company’s indebtedness to that other person; or
 - (ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.
- (4) The interest or security holder may not unreasonably withhold consent in terms of subsection (3)(a), having regard to—
- (a) the purposes of this Chapter;
 - (b) the circumstances of the company; and
 - (c) the nature of the property, and the rights claimed in respect of it.
- (5) The business rescue practitioner or an affected person shall be entitled to approach the court for the purpose of authorising the disposal of property subject to such security or title interests.

6.3.7 TREATMENT OF PRE AND POST-COMMENCEMENT CREDITORS

An aspect that has received much attention is the treatment of creditor claims. It has been observed that the Act does not provide specific protection for unsecured creditors who may have provided goods or services within a specific period immediately prior to the commencement of proceedings. This category of creditor, despite having provided goods or services which may be critical to the business of the company, remains at the mercy of the business practitioner (and hence the plan) where it does not have any form of security over the debtor’s assets in the form of a cession of book debts, notarial or mortgage bond. This is even more pertinent where the creditor is a provider of specialised goods or services or where the debtor company is its largest client.

Supplies made to the debtor within a specific time period before proceedings should be given some form of preference in terms of payability.⁶² In this way, a limited preference for vendors who supply goods or services within a specific time period preceding business rescue proceedings (with a cap on the value of preference

⁶² This could mitigate the prospect of a ripple effect where the financial distress of a debtor results in the financial distress of its creditor due to a dividend proposed in terms the rescue plan not being sufficient to ensure the liquidity of the latter or the honouring of debt to its own creditors.

accorded to this category) could be explored.⁶³ The U.S. critical vendor doctrine or the U.K. expenses of the administration may be a good starting point.⁶⁴ To recapitulate, the critical vendor doctrine permits the payment of certain pre-commencement claims upon motion by the debtor-in-possession while the U.K. expenses of the administration allows for the prioritisation of certain specified pre-administration costs and expenses.

This may, in conjunction with the above proposal, include a monetary or time period) cap on pre-commencement outstanding wage claims which are currently provided preference for their full value. In this way, supplier creditors whose claims fall within the relevant time period and amount are granted automatic preference in respect of the qualifying amount rather than the current approach which grants pre-commencement preference to employees for outstanding wages.⁶⁵ I recommend that a clause be incorporated to read as follows:

Limited preference for suppliers of goods or services immediately preceding business rescue proceedings

- (1) Where an independent creditor who is not an employee of the company provides goods or services within a period of 10 days before;
- (a) The adoption and filing of a company resolution commencing proceedings as contemplated in section 129; or
 - (b) The issuing of an application by the High Court Registrar as contemplated section 131, provided that such application is confirmed by an order commencing proceedings;

Provided that such independent creditor has not received any form of security for goods or services supplied and delivered, it shall be entitled to a limited preference on its claim for supplies made within the period in subsection (1) not exceeding a monetary value gazetted and published from time to time by the Minister of Trade and Industry. Such limited preference shall rank in priority to any concurrent claim and shall be due and payable at any time prior to the publication and voting on the proposed rescue plan as contemplated in sections 150, 151 & 152.

This however leads to the broader challenge with the Act; a failure to stipulate how preferent claims are to be treated in terms of the proposed business rescue plan. The order of preference applicable in terms of the plan is largely left to the practitioner's discretion in terms of section 150(2)(b)(v). The Act also makes various references to insolvency law. Section 150(2)(a)(iii) requires the proposed plan to provide an indication of which creditors would qualify as secured and statutorily

⁶³ Here the cap may relate to time period (e.g. supplies made within ten business days of the relevant documentation having been filed as CIPC or before the section 131 application is issued by the High Court Registrar, provided that proceedings receive court sanction) or monetary value (e.g. to a maximum value of R12 000) or both.

⁶⁴ A doctrine similar to that of the critical vendor or the granting of equitable powers to our courts would work best with a court-oriented procedure.

⁶⁵ Which are not capped in terms of time period or monetary value.

preferent in terms of insolvency.⁶⁶ The proposed plan must further illustrate (1) the probable dividend that would have been received in liquidation⁶⁷ and (2) the benefits of adopting the plan in comparison to a probable position in liquidation.⁶⁸ The binding offer provisions in section 153(1)(b)(iii) make a similar reference.⁶⁹

It is therefore not clear whether a pre-commencement creditor ranking as preferent is to be paid in full before payment of concurrent creditors or whether it may like any other creditor be subject to a compromise in terms of the proposed plan, without reference to its preferent status.⁷⁰ Only pre-commencement employee remuneration claims on the current wording seem to fall within this category.⁷¹ Section 136(1)(a) stipulating that, upon commencement, employees continue to be employed on the same terms does not seem to be of much assistance in interpreting the treatment of preference. However, such preferent creditor (including a secured creditor) may advance the argument that, in terms of the definition of ‘business rescue’, it would have derived a higher return in liquidation and that as such the value of its proposed dividend may not be less than a dividend receivable in liquidation.⁷² It is recommended that the Act be amended to clarify this aspect (i.e. the extent to which such category of claim may be compromised in terms of the plan). References to insolvency law within the context of plan proposals are unhelpful and ought to be removed.⁷³

6.3.8 RIGHTS ACCORDED TO EMPLOYEES

The regime may be lauded on the basis that it limits forum shopping on the part of directors/ managers in relation to relieving themselves of employee responsibility.⁷⁴ For instance, even though liquidation may relieve the company of certain obligations,

⁶⁶ Companies Act of 2008, section 150(2)(a)(ii). The provision has been rendered largely irrelevant in light of *Commissioner of South African Revenue Services v Beginsel NO and Others* (15080/12) [2012] ZAWCHC 194; 2013 (1) SA 307 (WCC) (31 October 2012).

⁶⁷ Section 150(2)(a)(iii).

⁶⁸ Companies Act of 2008, section 150(2)(b)(vi).

⁶⁹ See further section 153(7)(c) stipulating factors to which the court may have regard in setting aside a dissenting vote.

⁷⁰ See section 150(2)(b)(v).

⁷¹ Companies Act of 2008, section 144(2).

⁷² In terms of section 128(1)(b)(iii). However, see concern raised regarding the Act’s aggregation of creditor welfare and the example of a creditor such as SARS above.

⁷³ This is especially more so in light of the difficulty faced in relation to accurately quantifying the probable value of a liquidation dividend before lodgement of a final liquidation and distribution account to the Master. This factor makes the exercise somewhat speculative and open to abuse.

⁷⁴ John Armour and Simon Deakin ‘Insolvency and employment protection: the mixed effects of the Acquired Rights Directive’ (2003) 22 *International Review of Law and Economics* 443.

being in liquidation may impose significant costs on both viability and overall profitability. In this way the costs of initiating business rescue for managers and directors may be less in comparison to the costs of being in liquidation, especially when weighed against potential benefits of recourse to each.

However, the current provisions present a real risk of legislative arbitrage for employees as creditors in business rescue rather than in insolvency. This is due to the strength and ranking of employees' claims within business rescue proceedings in comparison to a ranking in liquidation.⁷⁵ It is recommended that ranking of claims in terms of section 135 be set out as follows and in descending order: (i) costs of business rescue, (ii) practitioner remuneration, (iii) pre-commencement secured claims, (iv) capped pre-commencement preference for certain categories of creditors as recommended above, (v) post-commencement remuneration entitlements, (vi) post-commencement secured and unsecured claims and (vii) pre-commencement concurrent claims subject to the practitioner's proposals. I recommend that 'post-commencement finance/ing' be defined as follows:

'Post-commencement finance' means the value of money, whether cash or otherwise, advanced by a lender or financial institution to the company after commencement of proceedings. This shall include the provision of goods or services on credit made by a supplier during this period.

Section 135 should be amended to read as follows:

135 Post-commencement finance

- (1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee—
 - (a) the money is regarded to be post-commencement financing; and
 - (b) will be paid in the order of preference set out in subsection (3) (a).
- (2) During its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1), and any such financing—
 - (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
 - (b) will be paid in the order of preference set out in subsection (3)(b) (c).
- (3) After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated—
 - (a) in subsection (1) will be treated equally, but will rank below-
 - (i) Pre-commencement secured claims;
 - (ii) limited pre-commencement preferent claims for the supply of goods or services immediately preceding commencement of proceedings as contemplated in this Chapter;
 - ~~(a)-(b)~~ Notwithstanding the ranking in paragraph (3)(a) claims in in subsection (1) will be treated equally, but will have preference over—
 - (i) ~~all~~ claims contemplated in subsection (2), irrespective of whether or not they are secured; ~~and~~
 - ~~(ii) all unsecured claims against the company; or~~

⁷⁵ See discussion in Chapter 4.

~~(b)-(c)~~ claims in subsection (2) will have preference in the order in which they were incurred over ~~all~~ pre commencement unsecured concurrent claims against the company.

(4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.

It is recommended that a concept similar to ‘adequate protection’ in the U.S. be incorporated into our Act. Within the context of our regime this could be interpreted to mean that before any further encumbrance of a secured creditor’s interest in order to obtain additional finance, there must be a sufficient ‘cushion’ to ensure that an existing interest is not diluted and its value diminished. In this way it is suggested, for example, that a debtor be permitted to further encumber an already existing secured interest only where the existing creditor is ‘over secured’ in relation to the debt owed.⁷⁶ This will ensure that where company property is to be further encumbered to procure much needed finance, pre-commencement security interests are not unduly diminished without consent or effective protective mechanisms in the Act. If the company is not able to provide this protection when seeking to obtain critical finance, it is submitted that, in line with the practitioner’s duty to continuously investigate the company’s prospects in terms of section 141(2), proceedings terminate and the company be liquidated. This will act as an important safety mechanism in light of the crystallising effect of section 135(4).

In the U.S. Bankruptcy Code, adequate protection seeks to ensure that pre-existing contractual security interests are protected. This may occur by requiring the debtor to provide some form of equity cushion; where the value of existing collateral is at a certain percentage in relation to debt (for instance, such as a collateral-to-debt ratio of 150%) or through the debtor ensuring that an ‘indubitable equivalent’ of the creditor’s interest in the property is in place.⁷⁷

It may be tempting to recommend that (in a manner similar to the treatment of pre-bankruptcy bargaining contracts in terms of the U.S. chapter 11 procedure) the amendment of employee-bargaining agreements be expressly sanctioned during commencement of the procedure. It has been observed that in terms of section 136, an employee’s contract of employment (as a default position) remains intact. Where a retrenchment is contemplated, it must comply with the provisions of sections 189 and

⁷⁶ This may occur where the property over which a creditor has security for its claims appreciates in value beyond the amount owed to it by its debtor.

⁷⁷ These are by no means the only way in which adequate protection may be created for an existing debtor. See 11 U.S.C § 361 and discussion in Chapter 5.

189A of the Labour Relations Act.⁷⁸ The Labour Relations Act contains important parameters for labour contract rejection.⁷⁹

An employer contemplating retrenchments must ensure that its engagement with employees is both procedurally and substantively fair. It is important for the Companies Act to clarify whether or not employee related arbitration proceedings (as opposed to purely contractual arbitrations) are subject to the moratorium in terms of section 133.⁸⁰ In light of section 210 of the Labour Relations Act read with sections 5 and 136 of the new Companies Act, it is unlikely that such proceedings are barred.

6.3.9 VOTING ON THE PROPOSED PLAN

An aspect that has received attention in both the analysis of business rescue and chapters discussing comparative law is the difference in approach, adopted in relation to the manner in which a creditor's voting percentage is determined. In light of the discussion in the previous chapter, it is unclear why creditors whose claims have been submitted are entitled to vote on the full value of their claim (without regard to the extent of any security held for such claim).⁸¹

The current approach may be justified on the basis that the South African post-commencement financing provision has a significant (and potentially diminishing) effect on existing security interests without attendant protections seen in jurisdictions such as the U.S. in the form of adequate protection. This aspect has been compounded by the manner in which section 135 has been interpreted by the courts.⁸² It would seem that the current approach compensates a secured creditor for the risk of having its security potentially diluted, by providing it with greater participatory power through voting.

The danger with this approach is that it may, in certain circumstances, make the right subject to abuse, where a limited number of secured creditors 'high-jack' proceedings without their security legitimately being at risk. The incorporation of

⁷⁸ Labour Relations Act 66 of 1995.

⁷⁹ It would seem that as long as a practitioner complies with due process as envisaged in the Labour Relations Act (s 189A), the termination of an employment contracts need not only occur in terms of a proposed business rescue plan and may in fact precede plan publication. See *Solidarity Obo BD Fourie & Others v Vanchem Vanadium Products (Pty) Ltd and Others supra (obiter)* at para 35.

⁸⁰ The dispute resolution and arbitration processes may take a considerable amount of time, which the financially ailing company cannot afford, considering its circumstances.

⁸¹ A related matter is the confusing manner in which section 145(4) has been drafted and particularly its reference to a 'concurrent creditor who would have been subordinated in a liquidation' when determining the value of a voting interest.

⁸² See Chapter 4.

doctrines such as adequate protection (recommended above) and amending a creditor vote to reflect only the deficiency between its claim and any security held for the purpose of calculating a voting interest, may serve as an important buffer between the ordinary concurrent creditors *viz-a-viz* their secured counterparts. In addition, recommendations made in relation to section 135 of the Act have proposed protections for pre-commencement secured creditors which will (if adopted) render the current approach to voting interests unnecessary. I recommend that section 145(4) be amended to read as follows:

145 Participation by creditors

...

- (4) In respect of any decision contemplated in this Chapter that requires the support of the holders of creditors' voting interests—
 - (a) a ~~secured or unsecured~~ creditor has a voting interest equal to the value of the amount owed to such creditor by the company, taking into account any security interest held by it over the existing debt. Such creditor shall be entitled to vote on a proposed business rescue plan to the extent that there is a deficiency between its security interest and the full amount owed to that creditor by the company; and
 - (b) a concurrent creditor who would be subordinated in a liquidation has a voting interest, as independently and expertly appraised and valued at the request of the practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in such a liquidation of the company.

6.3.10 TERMINATION OF PROCEEDINGS

A provision enabling the setting aside of the resolution and terminating proceedings⁸³ on the basis of material non-(or mal) performance⁸⁴ of the terms of the adopted business rescue plan may go a long way in strengthening the rights of affected persons during proceedings. The courts have provided scope for affected persons to challenge the manner in which a practitioner is implementing an adopted plan but have repeatedly held that, once a plan has been adopted by creditors, there is virtually no scope or clear direction for an application to be made by a creditor for the resolution to be set-aside and proceedings terminated.⁸⁵ The potential effects have been discussed at length in Chapter 4. A clause providing for an affected person to apply for termination of proceedings specifically where substantial/material breach of the business rescue plan has occurred could incorporate a much-needed level of accountability. It is recommended that section 130(1) be amended as follows:

⁸³ A deemed termination or at minimum a lifting of the moratorium against legal proceedings once notice and an opportunity to remedy has been provided to the debtor to remedy the breach. Such a provision would, however, have to be given careful attention when drafting.

⁸⁴ Or substantive non-performance.

⁸⁵ See discussion in Chapter 4.

130 Objections to company resolution commencement of proceedings

- (1) Subject to subsection (2), at any time after the adoption of a resolution in terms of section 129, until prior to the filing of a notice of termination of business rescue proceedings to the Commission in terms of section 132(2)(b) or (c), the adoption of a business rescue plan in terms of section 152, an affected person may apply to a court for an order—
- (a) setting aside the resolution, on the grounds that—
 - (i) there is no reasonable basis for believing that the company is financially distressed;
 - (ii) there is no reasonable prospect for rescuing the company;
 - (iii) The company has breached a material provision of the adopted business rescue plan and has despite receiving notice, failed to remedy or provide an undertaking to remedy the breach; or
 - (iii)(iv) the company has failed to satisfy the procedural requirements set out in section 129;⁸⁶

To circumvent creditors who may be unduly aggressive in their approach by deliberately seeking to have the company liquidated despite its recovery potential, it is recommended that a clause that allows for post- adoption plan amendment (within limitations) be incorporated into the Act. This is important in light of the fact that the Act does not have a framework for post- adoption plan amendments (currently finding application in industry).

Post-adoption plan amendment often occurs where the plan, due to a change in circumstances⁸⁷, cannot be performed in its original adopted form. This approach could resolve the *lacuna* that currently exists. I recommend that the provision reads as follows:

Modification of business rescue plan after adoption

- (1) The business rescue practitioner shall be entitled to amend an adopted business rescue plan where in his/her view, circumstances prevent the full implementation of the rescue plan in its original form subject to subsection (2);
- (2) The practitioner shall not propose to amend an adopted rescue plan more than once. Where an amendment to an adopted plan is contemplated, such amendment must—
 - (a) Be reasonably necessary for the full implementation of the initially adopted rescue plan;
 - (b) Include a notice to creditors indicating the proposed revisions with a notice of the meeting sent to each creditor and any other holders of a security interest as if the meeting is one contemplated in section 151;
- (3) In addition to subsection (2), the original plan must—
 - (a) not have been substantially implemented;
 - (b) be presented with proposed amendments incorporated to be voted upon by creditors, to the extent that individual creditor claims have not been paid in full, as if the meeting to consider the proposed amendments is in terms of sections 150 and 151.
- (4) The provisions of sections 151, 152 & 153 shall apply *mutatis mutandis* to the meeting contemplated in sub-section (2).

⁸⁶ A few factors may, however, have to be considered. While post-commencement finance contracts may be binding on the company once entered into, the possible effect of such an approach on the binding agreement of an already adopted plan would have to be considered, especially where the remedy sought entails a simple termination of proceedings without the company being placed under liquidation, particularly where the company is yet in financial distress.

⁸⁷ Or certain assumptions upon which the adopted plan was contingent, not being met.

6.3.11 DISCHARGE FROM DEBT

Section 154(1) requires that a creditor accede (through the proposed plan) to a discharge of the whole or part of debt owing to it. However, section 152(4) provides that if the requisite majority of creditors voting in favour of the plan requirement has been satisfied, it is effectively binding whether or not a particular creditor was present or voted against it. The latter provision effectively renders the requirement of specific assent legally superfluous, creating unnecessary uncertainty. To remove any uncertainties and resolve some of the potential areas for abuse identified in Chapter 4, I recommend that ‘Substantial Implementation’ either be defined or alternatively, references to it be removed in favour of a requirement of ‘full implementation’⁸⁸.

In the light of the recommendation relating to the post-adoption plan amendment and the practitioner’s continuing duty to investigate the company’s affairs for reasonable prospect of the rescue initiative succeeding, there is no reason why a new requirement of ‘full implementation’ would be unreasonable in the circumstances. It is my view further that this approach is consistent with the reference in section 154 to ‘implemented in accordance with its terms and conditions’⁸⁹ and ‘approved and implemented’.⁹⁰

6.4 CONCLUDING REMARKS

The impetus behind business rescue as a regime has been much discussed and need not be repeated. From a legislative perspective, there has been an incremental and positive shift from the need to create a regime solely to protect ‘institution[s] which helps the country’ to one containing multiple purposes underpinned by our Constitution and a rescue regime accessible to companies. While challenges in identifying the ‘bottom-line’ value of the new regime for the economy have been highlighted⁹¹, business rescue is an innovative and fresh approach when compared to the previous regime. In line with internationally recommended approaches, it sets out to encourage economic enterprise, whether through returning an entity to a position of solvency or salvaging whatever value is left in its business; transferring this value it to

⁸⁸ This may be defined as entailing ‘satisfying all requirements and conditions stipulated in the adopted or subsequently amended plan to the exclusion of any legal/natural/ commercial impossibility which may render the performance of obligations in terms of the plan impossible or financially unfeasible’.

⁸⁹ Sub-section (1).

⁹⁰ Sub-section (2).

⁹¹ In terms of the regime’s ability to restore companies to a position of solvency as a primary objective.

a new or existing market competitor in a way that contributes to economic development and employment creation.

Provided that the new regime obtains the proper buy-in from all relevant stakeholders and is implemented in accordance with its overarching spirit and purport, the multiple objectives set-out in section 7 of the Companies Act 2008 are well capable of being achieved. It is also inevitable that due to its infancy, teething challenges (both conceptual and practical) will be encountered and must be rigorously addressed. In this sense ours is, at minimum, a responsibility to ensure that business rescue remains responsive and perhaps even more importantly, that its value is unlocked for our developing economy; that a new path, different to that of judicial management, is charted.

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